Tax Policy in Ukraine, 2002

A Review of Current Issues with Recommendations

Support for Economic and Fiscal Reform Project*
Development Alternatives, Inc (DAI)
April 2002

* Project funded by the United States Agency for International Development (USAID).

Contents

Executive Summary

Tax reform in Ukraine has made great strides over the last decade. While the road to a stable, equitable, and modern tax system has been bumpy at times, there is no doubt that today's tax system is better than the tax system of five years ago. However, tax reform has stalled over the last two years, as the principal participants in the tax reform effort have struggled to reach consensus on the contents of the Proposed Tax Code. Most discussions regarding the Code have focused on the number of taxes, the rates of tax, and the availability of tax privileges. Nevertheless, it appears that most government officials and members of the Verkhovna Rada are committed to the adoption of a Tax Code in one form or another.

Tax legislation in Ukraine is basically sound, although there is substantial room for clarification of policies and definitions, and there are major tax loopholes to be filled. For the most part, the quality of the legislation has deteriorated significantly over the last few years, as amendments have put into place a vast array of tax privileges and exemptions, significantly eroding the tax base. In the current economic environment in Ukraine, reduce tax rates are required to increase economic growth and decrease the incentive for business activity to take place in the shadow. In order for Ukraine to be able to afford the needed rate reductions, it is necessary to substantially broaden the tax base, reversing the trend towards giving specialized tax privileges and off-setting the expected revenue costs imposed by lower rates.

There are several issues in tax policy that have recently received considerable attention, and which require immediate remedy. The pressure to correct these problem results from their direct contribution to the poor performance of the major taxes in Ukraine.

- VAT refunds, which has led to a public disagreement between the IMF and the government of Ukraine over its resolution.
- Net Operating Losses, which are poised to land a leveling blow on profits tax collections, leaving the budget with a significant revenue shortfall.

The VAT base should be significantly broadened to significantly increase VAT collections, thereby funding the required VAT refunds. In addition, the Collections Law should be amended to improved enforced actions against delinquent taxpayers, serve notice to third parties, and the use of indirect methods. STA methods and procedures regarding NOLs should be brought into line with existing legislation, meaning that end of year reconciliation should be allowed. In addition, procedures used to track NOLs should be improved. In addition, the special privileges awarded to the metallurgical sector should be revoked. The use of special accounts to capture VAT paid on electrical purchases is supported. Special tax treatment for agricultural enterprises should be revised, and legislation should be brought into line with the 6th Directive of the European Union.

Ukraine should move to amend and adopt the Proposed Tax Code. A tax code would ensure that consistent definitions and procedures are utilized for each of the various taxes that are paid by enterprises and individuals. In addition, a tax code would significantly improve the ability of the State Tax Administration to administer the tax laws in an equitable fashion and the ability of taxpayers to comply with the tax laws. By correcting many of the shortcomings of present law, a tax code would also reduce the need for the Government and the Verkhovna Rada to regularly amend the tax laws, which would provide much-needed stability to the tax system. Finally, by reducing tax privileges and increasing the non-taxable minimum income for the personal income tax, a tax code would dramatically improve the fairness of the tax system. The government should focus its efforts on the revision of the tax code, ensuring that the resulting legislation is internally consistent and free of loopholes, taxes all Ukrainian-source income, and is revenue neutral when compared with existing legislation. A single rate for the personal income tax should be adopted to minimize administrative costs and reduce shadow activities. The qualification requirements that physical persons should satisfy to participate in the simplified system of taxation should be extended to include a criteria based on net income.

As Ukraine moves into the next phase of reform, particular emphasis should be placed on making the correct choices in four policy areas:

- *Rate Reductions.* The rate reductions included in the latest version of the Proposed Tax Code stand to cost the budget over 7.5 billion UAH, or approximately 23% of total tax revenues. For this reason it is necessary to reduce rates where they will have the most impact. Direct tax rate reductions are more likely to enhance economic growth than reductions in the indirect taxes.
- *Base Broadening.* The expansion of the tax bases is essential. The recent standoff between the Government of Ukraine and the IMF resulted from the fact that VAT base has shrunk to the point where the tax no longer raises sufficient revenue to fund its own refunds.
- *Payroll Taxes.* Social taxes in Ukraine are significant, and are due for reform. Payroll tax rates are very high (totaling 42%), although the ceilings are not excessive. There is strong pressure to reduce the payroll tax rates, but the issue is being raised at a time when pension outlays are due to increase by 10% (July 1st).
- *Simplified System of Taxation.* While the current simplified system is considered to result in significant loss of revenue to the budget, there is certainly a place for a simplified system. There is a need to reform the simplified system to minimize the sheltering of taxable income, while providing a legitimately simplified system that will foster business development in what is likely to be a very dynamic business sector.

There are clearly many other issues that need to be addressed before the tax reform process in Ukraine can be considered approaching completion. This document aims to shed light on existing problems and provide support for potential solutions.

I Introduction

Summary: *Tax Reform in Ukraine has stalled. The Proposed Tax Code has not been adopted, and has not evolved to the point where it is ready to be adopted. Tax privileges undermine the revenue capacity of the major taxes and are growing in number rapidly. Most recent changes to tax legislation have narrowed the tax base and reduced the fairness of the tax system. The Verkhovna Rada has been responsible for promoting most recent movement in tax legislation.*

SEFR Position: *The election of a new Parliament provides a unique opportunity for the Government and the Verkhovna Rada to establish a positive working relationship. The Government should provide strong, sound leadership in the drafting and promotion of new legislation, and should act to reduce the number of privileges, thereby broadening the tax base, and increasing the fairness of the tax system.*

Tax reform in Ukraine has made great strides over the last decade. While the road to a stable, equitable, and modern tax system has been bumpy at times, there is no doubt that today's tax system is better than the tax system of five years ago. However, tax reform has lost some momentum over the last two years, as the principal participants in the tax reform effort have struggled to reach consensus on the contents of the Proposed Tax Code (PTC).[1] Most discussions regarding the PTC have focused on the number of taxes, the rates of tax, and the availability of tax privileges. The tax reform effort has also taken some detours, most notably the so-called Small Tax Code in 2001.[2] Nevertheless, it appears that most government officials and members of the Verkhovna Rada are committed to the adoption of a Tax Code in one form or another. To simplify the process of adoption, there is currently a widely held intention to proceed with the formulation of a Tax Code through the drafting and passage of a sequence of separate pieces of legislation.[3]

The success of this "piece by piece" approach to the development of the PTC is far from certain. Forward progress in the area of tax reform has generally fit the pattern of "two steps forward, one step back". The year of 2001 was generally a "one step back" year, although there were some improvements made to legislation. As examples, the following legislative amendments represented general improvements to the legislative environment:

- Law #2406-III, which stipulates that expenses incurred in the process of quality control are deductible for profits tax purposes; and
- Law #2905-III, which presents a set of definitions that are designed to improve the administration of the personal income tax law.

Countering these improvements, the following amendments, also adopted in 2001, were generally unsupported by the proponents of Tax reform.

---

[1] The Tax Code was approved by the Verkhona Rada in the First Reading in July 2000. It was passed in the Second Reading in December 2001. It represents a consolidation of all tax laws, providing consistent use of definitions, improve drafting, and modernization of many components of the legislation.

[2] The so-called Small Tax Code is best thought of as a set of tax rate reductions amended to current legislation.

[3] This position is reportedly consistent with the views of Minister of Finance Ihor Yushchko, as well as Deputy Head of the Banking and Finance Committee of the Verkhovna Rada, Sergiy Teriohin. Interestingly, other policy makers, reportedly including the Head of the Banking and Finance Committee, Valeriy Alioshin, support the PTC as a single document.

- Law #2905-III, which stipulates that physical assets that are not currently in service are to be excluded from the depreciation deduction of the enterprise profits tax; and
- Law #2233-III, which continues the practice of allowing qualifying enterprises in the agricultural sector to retain collected VAT for use in purchasing production supplies.

Some amendments were a combination of welcome and undesirable, as those drafting the legislation struggle with new concepts. For example, Law of Ukraine No. 2899-III made great strides towards ridding the private investment environment of tax-based distortions, but also created an uneven playing field when it eliminated the use of promissory notes for the settling of VAT debts at the time of imports only for joint ventures.

The Annex includes a comprehensive list of tax law changes for 2001, over fifty in all. As a rule, the vast majority does not represent improvements to legislation. The primary reason for this is the pending Parliamentary elections, which have been guiding the hands of the members of parliament as they sought to distribute tax privileges to all corners of Ukraine, and have left the proponents of tax reform with their hands tied.

The beginning of 2002 saw major changes within the Government of Ukraine, most notably in the Ministry of Finance. The former Minister of Finance, Ihor Mitiukov, was replaced because of "unsatisfactory performance regarding the formulation of tax policy".[4] The naming of Ihor Yushchko, formerly the State Secretary of the Ministry, as Minister of Finance, was followed by a large push within the Department of Tax Policy and Macroeconomic Forecasting to address many of the drawbacks of the tax system. Currently, legislation is being drafted both to close existing tax loopholes and to move forward with the development of the Tax Code.

This new focus on tax policy has not yet made an impact on legislation. While there have been few changes to tax legislation so far in 2002, there have been no significant positive changes to speak of. In fact, in the last voting session of this session of the Verkhovna Rada, there were six changes to tax legislation, three of which were devoted to defining terms, and three of which were new or continued privileges:

- Draft Law #8417, "On Provisions of Implementation of Investment Projects in Turkmenistan", which provides EPT and custom preferences to companies engaged in certain types of investment activities in Turkmenistan;
- Draft Law #8179-D, "On Special Treatment of Investment and Innovation Activities of the Technological Parks 'Semi-Conductor Technologies, Materials, Optical Electronics and Sensor Technologies', O.E. Paton Electric Welding Institute', 'Institute of Monocrystals', and 'Vuhlemash';
- Draft Law 7231, "On the Amount of Rates of Some Social Insurance Taxes", which provides a reduced payroll tax burden to enterprises employing a sufficiently large number of disabled persons.

Clearly, the reform-minded thoughts of the government have not yet translated into reform-oriented legislation passed by the Parliament.

Nevertheless, Tax Policy in Ukraine is poised for a large step forward. The failure of the PTC has been recognized by the Ministry of Finance and the Verkhovna Rada, and the two organizations are currently negotiating the contents of future, entirely new, pieces of legislation to take its place. The mandate of the Ministry of Finance to find new solutions to

[4] Comments of Ukrainian Prime Minister Anatolii Kinakh, reported in Ukrainian News Agency Morning Edition #494, December 28th, 2001.

existing problems breathes new life into the tax reform process, and the new spirit of cooperation between the VR and MinFin leaves open the possibility for success, where in the past there has been stalemate.

II Taxes in Ukraine

Summary: *The underlying tax legislation in Ukraine is basically sound. The erosion of the tax base has lead to ever-poorer revenue performance, which is threatening the foundation of budget execution. The need to reduce tax rates to make Ukraine more competitive for purposes of business development will significantly increase the pressure on the Budget.*

SEFR Position: *Reduce tax rates are required to increase economic growth and decrease the incentive for business activity to take place in the shadow. In order for Ukraine to be able to afford the needed rate reductions, it is necessary to substantially broaden the tax base, reversing the trend towards giving specialized tax privileges and off-setting the expected revenue costs imposed by lower rates.*

Ukrainian legislation includes a standard array of taxes, some implemented nearly ten years ago, while the major pieces of tax legislation are about five years old. Legislation in Ukraine is basically sound, although there is substantial room for clarification of policies and definitions, and there are major tax loopholes to be filled. The four major sources of revenue in Ukraine are:

- The Value Added Tax was adopted in April 1997, with accrual accounting implemented in January 1999, providing Ukraine with a modern invoice-based VAT generally consistent with International practice. This law was developed to be consistent with the best practices of the West. It contains a single 20 percent rate, requires invoices, liability is calculated by the credit method, and international trade is based on the destination principle. The VAT is currently responsible for approximately 32% of tax revenues paid into the Consolidated Budget.
- The Law on Excises was adopted in 1992, and levies excises on a large number of products. The list of excisable products is consistent with international practice, including alcoholic products, tobacco products, petroleum products, and automobiles. It also includes other items, including electronic equipment, food items, and selected consumer goods. Most rates are specific and given in Euros. Rates are identical for domestic and imported goods. Excises in Ukraine account for approximately 8% of tax revenues paid into the Consolidated Budget.

Table 1

Sources of Tax Revenue, 2001(Million UAH)

	Consolidated Budget		State Budget		Local Budgets	
	Revenue	% of Total	Revenue	% of Total	Revenue	% of Total
Total	31,958	100.0%	19,292	100.0%	12,666	100.0%
Value Added Tax	10,355	32.4%	10,355	53.7%	-	0.0%
Personal Income Tax	8,774	27.5%	-	0.0%	8,774	69.3%
Enterprise Profits Tax	8,151	25.5%	6,156	31.9%	1,995	15.8%
Excise Taxes	2,654	8.3%	2,383	12.4%	271	2.1%
Resource-Based Taxes	2,024	6.3%	398	2.1%	1,626	12.8%

- The Enterprise Profits Tax was adopted in May 1997, and became effective in July of that year. The EPT is generally consistent with international practice. Most activities are taxed at a single rate of 30%, most business-related expenses are deductible, and depreciation rules are accessible.[5] The EPT in Ukraine accounts for approximately 25% of Consolidated Budget revenues.
- The Personal Income Tax was implemented by Decree of the Cabinet of Ministers in April 1993. It is a significant source of revenue for local finance, and is responsible for about 70% of the revenue paid into Local Budgets. The PIT generates about 28% of the revenue paid into the Consolidated Budget.

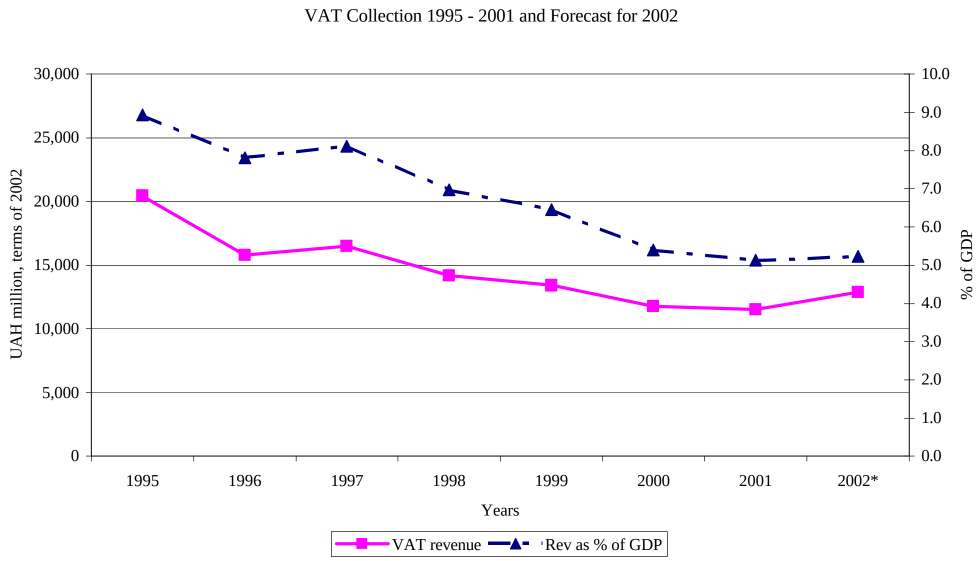
For the most part, the quality of the legislation has deteriorated significantly over the last few years, as amendments have put into place a vast array of tax privileges and exemptions, significantly eroding the tax base.

The two taxes most affected are the VAT and the Enterprise Profits Tax. With the exception of a slight upturn in 1997, VAT revenues have continued their decline through 2001, both in real terms and as a percent of GDP. As can be seen in Figure 1, VAT has fallen from an average of 7.7 percent of GDP over the period of 1995 to 1999, to 5.4 percent of GDP in 2000, and 5.1 percent in 2001. The real decline in revenues follows the same pattern. The performance of the Enterprise profits tax is equally unimpressive. Falling from nearly 10% of GDP in 1995 (averaging 6.5 percent of GDP over the 1995 to 1999 period), revenues have continued on a monotonic slide through 4.4 percent in 2000 and 4.1 percent in 2001 (see Figure 2). In both cases, revenue projections for 2002 forecast a reversal of these negative trends.

The revenue forecasts that are used as a basis for the Budget Law of Ukraine have also historically performed poorly. In 2001, VAT revenues fell short of Budget projections by UAH 1.2 billion, or over 10 percent. Also in 2001, Enterprise Profits Tax performed at 97 percent of budgeted levels, and Excises managed 93 percent. On the bright side, the personal Income Tax over-performed at a rate of 127 percent of budgeted levels. While Ukraine, as a transitional economy, provides a difficult environment to forecast, there is no doubt room for improvement in the methods used for budget projections. It is difficult to say whether the forecasted improvements in revenue performance expected in 2001 are based on sound analysis or simply unfounded optimism.

[5] Major portions of the EPT flow directly from *The Basic World Tax Code and Commentary* (Hussey and Lubick).

Figure 1
Value Added Tax



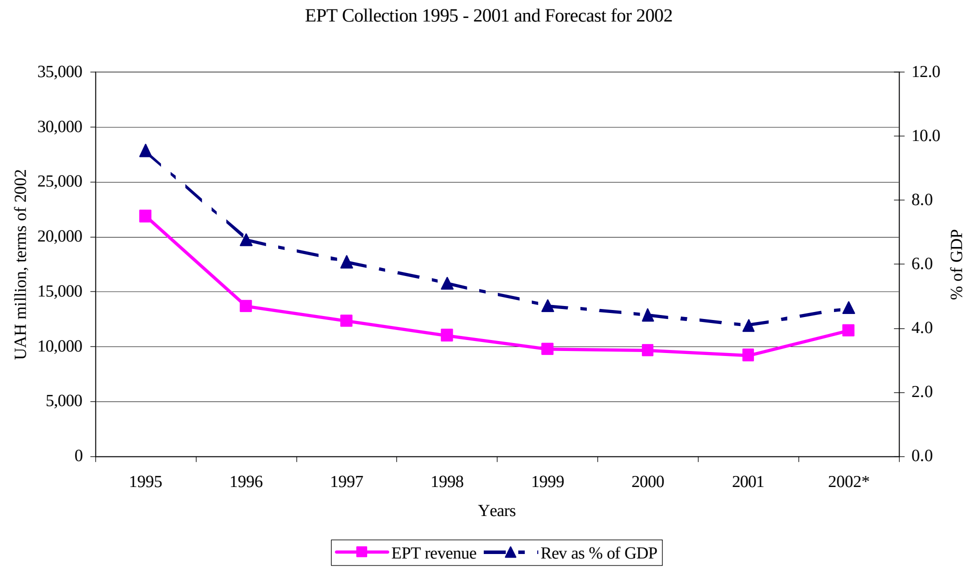
The shrinking of the tax bases is applying additional budget pressure at a time when Ukraine is considering significant rate reductions to stimulate business activity and bring activity out of the shadow. The PTC, as well as competing pieces of legislation envisions a reduction of the VAT rate from 20 percent to 17 percent, and a reduction of the Enterprise Profits Tax rate from 35 percent to 25 percent.[6] In order for these reductions to be viable, it will be necessary to reverse the many tax privileges that have been granted, and rebuild the major tax bases.

III Areas Requiring Attention

Summary: *There are a number of critical areas that should be resolved immediately. The first concern is that of VAT refund arrears, which have been identified by the IMF and a major issue to be resolved before the reestablishment of loan payments to Ukraine. The second concern involves Net Operating Losses (NOLs). The backlog of NOLs threatens to significantly decrease current and future Enterprise Profits Tax Collections. The third involves the special tax treatment of a number of important sectors of production in Ukraine, including metallurgy, electricity, and agriculture. Other important issues involve the wide spread use of promissory notes for budget payments, the lack of suitable transfer pricing rules, and the decision about how to tax raw petroleum being imported from Russia.*

[6] The personal income tax is also expected to see the rate of the top tax bracket fall from 40 percent to 25 percent.

Figure 2
Enterprise Profits Tax



> ***SEFR Position:*** *The VAT base should be significantly broadened to significantly increase VAT collections, thereby funding the required VAT refunds. In addition, the Collections Law should be amended to improved enforced actions against delinquent taxpayers, serve notice to third parties, and the use of indirect methods. STA methods and procedures regarding NOLs should be brought into line with existing legislation, meaning that end of year reconciliation should be allowed. In addition, procedures used to track NOLs should be improved. The special privileges awarded to the metallurgical sector should be revoked. The use of special accounts to capture VAT paid on electrical purchases is supported. Special tax treatment for agricultural enterprises should be revoked, and legislation should be brought into line with the 6th Directive of the European Union.*

While there have been major improvement is tax legislation in Ukraine over the last ten years, there are still many things that require improvement. In fact, most areas of legislation require reform, at least in the form of consolidation and improvements in drafting. That said, there are several areas that have recently received considerable attention, and which require immediate remedy. The pressure to correct these problem results from their direct contribution to the poor performance of the major taxes in Ukraine. Leading the list is the issue of VAT refunds, which has led to a public disagreement between the IMF and the government of Ukraine over its resolution. In addition (and in part related), is the issue of net operating losses, which are poised to land a leveling blow on profits tax collections, leaving the budget with a significant revenue shortfall.

III.A VAT Collection and Refund Arrears

The VAT in Ukraine has not performed well. In general, one would expect VAT collections to be sufficient to allow the disbursement of VAT refunds, with a sufficient percentage of net collection remaining after executing the refunds. Belgium, a net export country (like Ukraine) refunds about 30% of its collections, while in Ukraine, refunds are 56% of the collected VAT. This indicates that collections are too low, due either to a tax base that is not broad enough or an insufficient enforced collection system. The STA has come under heavy fire in the last year as a result of the perceived delays in the payment of VAT refund. For this reason, they have been playing the leading role in the resolution of VAT-related problems.

III.A.1 Enlargement of the tax base

Expansion of the VAT base requires changes to be made in the VAT law. The recent proposal of the STA "On changes to VAT law" suggests that there is no strong likelihood that an enlarged VAT base will be achieved in the near future. The proposed changes to the VAT law will probably not sufficiently increase VAT collections to the extent required to cover VAT refund arrears, as required by the IMF.[7] The main reasons are:

- The preferences of article 11 still remain – the exception made for the flat rate scheme for farmers that is similar to the scheme provided for by article 25 of the EU Sixth Directive, but with the proposed highest rate of 8 % instead of 6 % in the EU;
- No changes are proposed to the presumptive taxes, so that the losses in VAT-collections resulting from the simplified scheme of taxation remain;
- No measures are proposed for dealing with the VAT arrears with respect to the mounting inter-enterprise arrears – nor are the links with Enterprise Profit Tax addressed;
- The proposed payment system of VAT (the creation of a special bank account for the suppliers of the electricity) for final consumption in the energy sector is not sufficient to guarantee that VAT will flow into the Budget;
- Transfer pricing rules are not proposed – meaning that there will be no resolution to the problem of the valuation of transactions;
- The omission of other measures that could contribute to the improvement of refunds, such as an improved registration system (some measures are proposed), simpler refund system, clear and unlimited desk and field audit possibilities (including making inventories, direct bank access under certain conditions, other new audit techniques including indirect methods), and the retaining of VAT refund if indications prove that reported data are not correct and if it is impossible to finalize the related audit in due time.

The positive VAT changes proposed in the Draft Law are:

- The refund system for taxpayers with a history of accurate declaration and timely payment;
- The flat rate scheme for farmers (similar to the common flat-rate scheme for farmers provided for by article 25 of the EU Sixth Directive); and
- Tighter regulation of registration for VAT purposes, (although the changes are quite limited).

Other proposed changes include:

- The refund system for new taxpayers, which carry forward the refund for 12 months;
- More obligations imposed on exporters for proving that export actually takes place, and thus receiving the related refund. The most notable criteria is provided by the

[7] The IMF has required that Ukraine develop a plan to repay all VAT refund arrears in 2002 as a criteria for the continuation of the EFF loan program.

new wording of paragraph 8.1 of the VAT law, and the evidence provided by banks of the transfer of funds to a bank account in Ukraine;

- Finally, exclusion from refund if exports fail to provide payment to their suppliers.

Such changes are not in line with the 6^{th} directive of the EU.

III.A.2 Enforced collection of VAT

The Collection Law of Ukraine is often cited as one of the major reasons for the poor performance of the major taxes, most importantly VAT. The law fails to provide for adequate enforcement on the part of the tax administration, and as a result, results in a lack of respect for existing legislation. In particular:

- 70 days must expire before an enforced collection action can be taken (after a tax notice and two tax demands) without any exception (article 6 of the Collection law).
- A strict order of enforced collection measures must be followed in order to implement an arrest of property. Even if such arrest and the subsequent auction are technically possible, it seems often there is a *de facto* impossibility of any actual execution of the arrest (e.g. on state owned enterprises and in the energy sector). The strict order is reflected in the wording of the beginning of article 7.4.1 of the Collection law.
- Sending notices to third parties, e.g., the collection of VAT from the buyer in the event that payment is not made to the seller, is not implemented because the text of article 7.4.1 of the Collection Law is not clear.
- Tax debts have a statute of limitations of three years without interruption. No new period can start after interruption, generating *de facto* tax amnesties. See article 15 of the Collection law.
- Direct action against risky purchasers (buyers that satisfy established criteria for being potential non-payment threats) is not provided for in tax legislation/collection law.
- Guarantees provided by banks (article 8.8. of the Collection law) are not applied. Payment arrangements are possible, but this can easily be utilized to delay payment, followed by the termination of the agreement with non-payment. Most countries require a guarantee, but this is not provided for in the Collection Law, and the banks are not eager to provide guarantee for taxpayers with tax debts;

- The use of indirect methods has found no support in the Cabinet of Ministers or the Verkhovna Rada. Article 4.3.1 of the Collection Law envisages four cases for utilizing indirect methods:
  - Not filing return;
  - Evading providing information;
  - Not maintaining tax accounting records; and
  - A taxpayer cannot support the data of his return with available accounting documents if a controlling organ carries out documentary examination.

Table 2

Carry-forward accrued according to Order #306

	Quarters				
	First	Second	Thirds	Fourth	Year
Gross Income	340	330	350	320	**1,340**
Gross Deductions	180	320	280	250	**1,030**
Depreciation	70	75	80	65	**290**
Taxable Income	90	(65)	(10)	5	**95**
Previous Quarter's NOL	(10)	-	(65)	(75)	**(70)**
Taxable Income w/ NOL	80	-	-	-	**80**
NOL to be carried forward	-	(65)	(75)	(70)	**(70)**

Table 3

Carry-forward w/ end of year reconciliation

	Quarters				
	First	Second	Thirds	Fourth	Year
Gross Income	340	330	350	320	**1,340**
Gross Deductions	180	320	280	250	**1,030**
Depreciation	70	75	80	65	**290**
Taxable Income	90	(65)	(10)	5	**20**
Previous Quarter's NOL	(10)	-	(65)	(75)	
Taxable Income w/ NOL	80	-	-	-	**10**
NOL to be carried forward	-	(65)	(75)	(70)	-
Tax Due	24	-	-	-	**3**
Refund					**21**

However, the STA has no authority to prove non-reported income on basis of wealth indicators. Further, the use of an indirect method to determine tax liabilities is forbidden in all other cases (article 4.3.4 of the Collection Law).

III.B Net Operating Loss Carry-Forwards and Carry-Backs

Net operating losses (NOLs) are allowed to be carried forward for five years in Ukraine. Legislation calls for NOLs to be utilized to reduce liability on a quarterly basis, with an end-of-year reconciliation. However, practice in Ukraine differs somewhat from that which is envisioned in the legislation.

There are three issues to be resolved in the treatment of NOLs. First, STA Order #306 (dated July 12, 2000) prohibits the end of year reconciliation of NOLs. According to the order, NOLs are to be applied on a quarterly basis, which can have a significant impact on end of year liability. The Tables 2 and 3 provide example illustrating the differences in the calculation of the tax liability with and without reconciliation. In the example provided in the Tables, end-of-year taxable income of the taxpayer is increased from 10 to 80 by Order #306, thereby eliminating the refund of 21.

Secondly, current practice fails to limit the amount of NOLs to be carried forward by inadequately tracking the vintage of existing NOLs. The STA has recently drafted a proposal improve the accounting of NOLs accrued during the period of July 1, 1997 through July 1, 2002, through introducing of a NOL inventory. The proposal is intended to bring the tax return in line with the provisions of Collection Law and to prevent discretional accruing of tax deductions by taxpayers with the purpose to reduce tax liabilities.

It is proposed to do such tracking of NOLs through accounting in tax return, but this captures only initially created NOLs, while the NOLs created in the subsequent accounting periods during which the initial NOL is not redeemed, shall be accounted on off-balance accounts. This is a possible solution, though, for purposes of desk audit it is necessary to have additional information in the EPT return about NOLs accrued in different tax period. The proposal is in line with activities on tax service modernization.

However, since the EPT Law does not unequivocally rule out claiming of expenditures that were created in the past accounting periods as gross expenditures of the current accounting period, taxpayers may "forget" to do so, and deduct such an expense in the future accounting periods and reduce it first against the income received in such future period. This may create problems for automatic tracking of the history of creating of NOLs, and, as such, requires additional consideration. One solution may be adding a separate line in EPT return to account such "forgot" expenses.

While the STA's proposed tax ruling aims to prevent such practices, intending a strict order of reduction of NOL by the date of their accounting, it does not stipulate that clearly. Thus, an expenditure created in the 4th quarter of 1997 still may by deducted in year 2002 (and consequently accounted in the corresponding tax return for 2002), but it will be taken into consideration for compensating against incomes of that year only after being adjusted for NOLs accounted for previously (i.e., in 1998-2001). If not of all of such NOL are offset, then the loss of 1997 not accounted in that year (but only in year 2002) will be written off due to expiration of the allowed 20 accounting periods. The outstanding balance of NOLs is thought to be considerable, and this could have a significant impact on revenue is 2002.

Thirdly, there is the issue of loss carry-backs. STA Order #306 includes item 6.2, which clearly rules out any possibility of carrying back NOL within one tax year: "Taxpayers shall not be allowed to reduce the taxable object of the previous accounting (tax) quarter by the amount of NOL (taking into account amount of depreciation deductions) received in the [current] accounting (tax) quarter." As such, if during one accounting year taxpayer has both taxable income in one or more tax quarters and NOLs in another, the amount of the tax paid shall not be recalculated at the time of the annual return (4th quarter), taking into account the provision of accounting of EPT indicators on the basis of accumulated totals envisaged in article 16.4 of the EPT Law: "Taxpayers shall submit tax returns to revenue authorities within periods specified by law, which document shall reflect the revenues computed as an accumulated total from the beginning of the accounting year."

This is in contradiction with article 16.16: "Excessive tax payments to the budget accrued for the accounting period using an accumulated total as of the start of the year shall be taken on account of subsequent payments or refunded to taxpayer not later than ten working days from the date of written applications submitted by the taxpayers concerned." Moreover, the Collection Law clearly allows carry-back of NOLs: "If, according to tax accounting rules specified by laws, the tax returns with respect to an individual tax, liability is computed as a cumulative amount, the tax return presented as a result of the last tax period of the year shall be considered equivalent to the annual tax return. In this case, the latter shall not be submitted."

Finally, it is worth noting that NOLs are related to VAT liability as well. Since losses are often associated with negative value added, companies accumulating NOL's also tend to be applying for VAT refunds on intermediate consumption.

III.C Sectoral Issues

There are several sectors of production in Ukraine that have a history of receiving preferential tax treatment. Of these, the electrical and agricultural sectors have some basis as a result of their special position in the overall economy.[8] The metallurgical sector has, on the other hand, been the recipient of a string of "tax experiments" designed to test taxpayer behavior under differing conditions.

III.C.1 Electrical Sector

There are no issues to be resolved in the VAT legislation as far as the taxation of the electrical sector is concerned. The sale of electricity was subject to zero rate of VAT through January 1, 2001. Since that date, the sale of electricity has been subject to VAT at the regular rate of 20% and does not fall under any special regime for VAT purposes. There are, however, two special articles in the Enterprise Profits Tax law related to the electrical sector.

Pursuant to Article 22 of the Law of Ukraine # 283/97-VR of May 22, 1999 (Profits Tax Law), during the period ending January 1, 2003, electricity generating companies are entitled to claim a deduction for expenses incurred for repairs and modernization of fixed assets that were put into operation prior to January 1, 1993, given that the amount does not exceed 9% of the carrying value of such assets falling into groups 1 and 3 of the general assets classification. Under a general practice, expenses for repairs and improvements of fixed assets are deductible for all business entities within 5% of the carrying value of fixed assets.

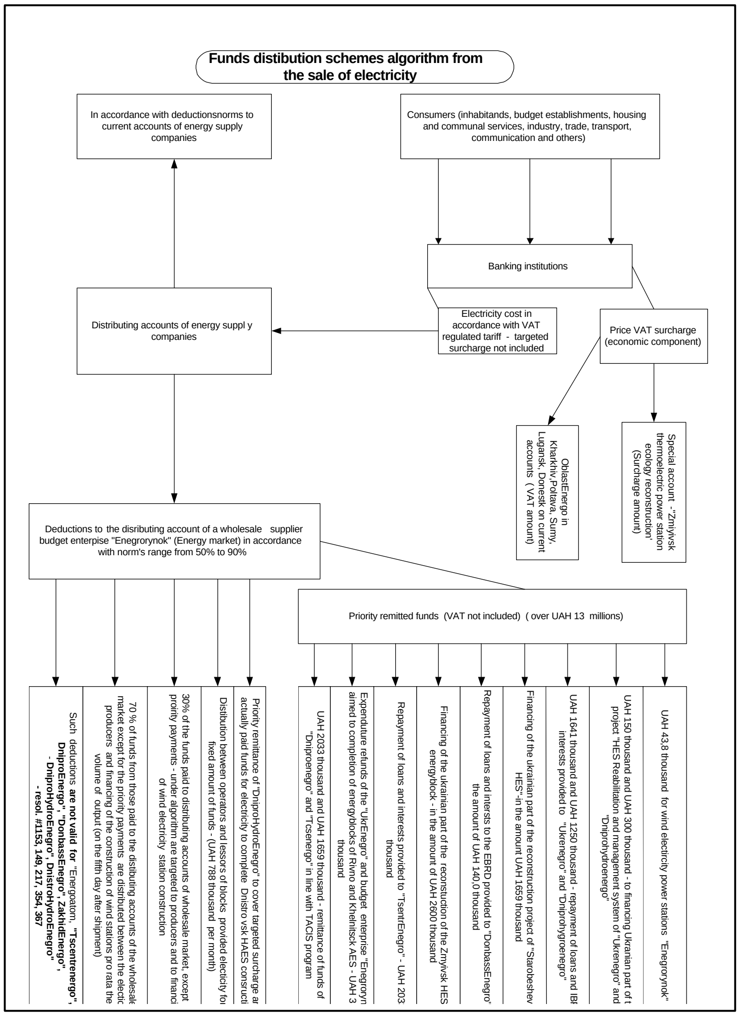
In addition, pursuant to Item 5.9 of Article 5 of the Profits Tax Law, energy-generating companies do not take into account quarterly variations of inventory and work in process for profits tax purposes. This is done on an annual basis.

Significant problem remain in the collection of budget revenues from the electricity sector, particularly with respect to VAT. These appear to be unrelated to tax legislation. The relations in energy sector of Ukraine are regulated by the Law of Ukraine "On the power industry" dated on October 16, 1997 #575/97 with changes and amendments.

There was an attempt to resolve the problem of non-payment for supplied electricity in the year 2000 through the introduction of distribution accounts and the elaboration of an algorithm of funds distribution from that account. This account is supposed to guarantee payment by electricity suppliers to electricity producers. According to the amended provisions of, in particular, Article 15-1 of this Law, "consumers, which purchase the electric power from power suppliers exercising business activities in the form of the supply of the electric power to the assigned area shall pay for the delivered electric power solely to a distribution account of a power supplier with an authorized bank."

Most of the funds remitted into the electricity supplier distribution bank account are to be transferred into the distribution account of the wholesale supplier of electricity, which is state-owned enterprise Energorynok. All wholesale supplies of electricity are to be executed only through this institution: "All electricity generated by power stations whose capacities or output exceed boundary indices, as well as at wind power plants, regardless of the value of the installed power or the electric power output (except electricity produced by heat and power

[8] Many countries have specialized tax systems for the agricultural sector, and the 6th Directive of the EU provides a special flat tax for farmers (Article 25). The importance of the electrical sector as an input into other key production sectors, as well as mounting inter-industry arrears, have resulted in special payment procedures for electrical companies.



plants as part of the structure of energy suppliers) to be consumed in the license-covered territory shall be sold on the wholesale energy market of Ukraine. No other wholesale energy markets shall be allowed to function. (Article 15).

Funds are distributed according to a formula, which is not based on the volume of supply, as electricity produced by atomic, hydro and thermal power stations have different cost. The algorithm is to be formulated by the National Commission on Issues of Regulation of Electricity.

The flow of funds in the electrical sector leads to revenue losses to the Budget. In particular, revenue can leak from the system in three ways:

1. Some part of VAT may not be collected due to non-payment by consumers for the delivered electricity. This is not a unique to the energy sector, and therefore may be dealt with through normal audit tools.
2. Consumers remit money for consumed electricity to the special distributing accounts of electricity suppliers. From that account money (VAT included), according to an established algorithm, funds are distributed to the settlement bank accounts of energy

suppliers (for services related to energy transportation etc.) and to the special distribution account of wholesale supplier of electricity Energorynok.

A certain part (up to UAH 13 million per month) of the funds accumulated on the distribution account of the wholesale supplier is allocated to finance some priority investments such as construction of wind power stations, reconstruction of some existing hydro and atomic power stations, etc. These allocations do not include VAT, so the total lump sum on which VAT is charged is reduced.

70% of the remaining amount is distributed among electricity producers according to the algorithm, which takes into account differences in the production costs of electricity. So, electricity producers, due to the design of the electricity market payment scheme, receive less VAT than they charge to their purchasers.

3. Having received the money from the wholesale supplier distribution account, the electricity producers often do not pay VAT due to the budget, but rather utilize these amounts for other purposes.

The STA proposal is to collect VAT before it is remitted (as a part of the lump sum of payments for electricity) into the distribution account of the wholesale supplier of electricity by way of the establishment of another specialized account for the collection of VAT. The SEFR Team generally supports this proposal, and it has been reported that the Cabinet of Ministers has recently implemented this proposal through the issuance of a decree.

III.C.2 Metallurgical Sector

Currently, the metallurgical sector does not fall under any of the special VAT regime. However, pursuant to Article 22 of the Profits Tax Law, in the period ending January 1, 2003, enterprises of metallurgical industry are entitled to claim deductions for expenses incurred for repairs and modernization of fixed assets that were put into operation prior to January 1, 1993 in the amount that does not exceed 9% of the carrying value of such assets falling into groups 1 and 3 of the general assets classification. Under general practices, expenses for repairs and improvements of fixed assets are deductible for all business entities within 5% of the carrying value of fixed assets.

Further, the Law of Ukraine #2975-III of January 17, 2002 “Concerning Further Development of Mining and Metallurgical Complex”, starting from January 1, 2002, 95% of the profits tax paid by certain enterprises of the metallurgical industry (as per the list to be approved by the Cabinet of Ministers) will be accumulated into a special account of the State Treasury. These funds will be used for funding investment projects, including projects for restructuring of the metallurgical companies, eliminating the use of ineffective and excessive production processes. In addition to the special use of profits tax revenue, this Law also provides that that the listed enterprises shall be entitled to use 70% of the environment pollution levy (accrued as payable to the Budget) for financing environmental projects.

The above legislation replaces the “tax experiment” in the sector. During the period from July 1, 1999, to January 1, 2002, a number of enterprises of the metallurgical and mining industry complex (per the list defined by the Cabinet of Ministers) fell under a special taxation regime introduced by the Law of Ukraine # 934-XIV of July14, 1999 “Concerning the Economic Experiment Regarding Mining and Metallurgical Industry Complex”.

The special taxation regime included the following:

- The amounts of penalties and financial sanctions accrued as per July 1, 1999 for untimely payment of taxes were written off. During the period of the economic experiment the companies that did not pay taxes in time were subject to two times lower penalty rates than those that were normally established by the legislation;

- The companies were exempt from the road tax and were to pay contributions to the Innovation Fund at the rate that was two times lower than the normal rate established by the legislation;
- Tax authorities were entitled to allow the companies to defer payment of taxes for a 60 month period without charging interest;
- The companies were entitled to use 70% of the environment pollution levy for financing environmental projects. Otherwise, this levy would be payable to the Budget;
- Profits tax was to be paid at the rate that was equal to 30% of the normal rate established by the legislation. The amounts accruing from the difference in tax rates were to be used for supplementing operating capital of the companies.
- The companies were entitled to claim deduction for expenses incurred for repairs and modernization of fixed assets that were put into operation prior to January 1, 1993 in the amount that does not exceed 15% of the carrying value of such assets falling under group1 and 3 of the assets classification;
- VAT was to be refunded within one month after the date of filing a monthly VAT declaration. Refund could be in cash or a Treasury promissory note. This note could be used for payment of taxes to the State Budget, payment of excise and customs duty on import of goods or for settlement of liabilities with other companies.

Recently, Prime Minister Kinakh reported that the government was continuing the “economic experiment”. What he was referring to was Law of Ukraine #2975-III, cited above. It is worth noting that the only holdover from the original “experiment” is the retention of the environmental pollution levy. Like all sector-specific tax privileges, this policy should be discontinued at the earliest opportunity.

III.C.3 Agriculture

Ukraine gives special treatment to the agricultural sector. A special regime is provided for agricultural producers by the Law of Ukraine # 168/97-VR of April 3, 1997. In the period ending January 1, 2004, agricultural producers with a share of gross income from the sale of agricultural products of own production and finished products produced from such agricultural products exceeding 50% of total gross income are entitled to not pay VAT to the Budget. The amounts of VAT accrued are to be used by such qualifying agricultural producers for the purchase of production supplies. This regime does not cover sale of milk and meat to companies processing these products, as these sales are zero-rated for VAT purposes.

Further, in the period ending January 1, 2004 agricultural enterprises shall not pay VAT to the Budget on sales of milk, cattle, poultry, wool and milk/meat product, produced at their own processing capacities. The amounts of VAT accrued are to be used by such producers for development of their own capacities in animal and poultry production.

Legal entities involved in producing agricultural products fall under the general regime of the profits tax with a number exceptions providing for special rules. These special rules as provided by the Law of Ukraine # 283/97-VR of May 22, 1999 (Profits Tax Law) are as follows:

- Article14 of the Profits Tax Law provides that

- Entities producing agricultural products are to pay profits tax based on the annual period. Normally, profits tax is paid by the entities based on quarterly declaration;
- Gross income and expenses are to be indexed by the inflation rate. This practice is not applied to entities of other industries;
- The amount of land tax is to be credited against the profits tax payable. Normally, other entities include the amount of land tax into deductible expenses.

These provisions cannot be applied to entities involved in the growing and selling flowers, the growing of wild plants, wild animals, producing wines, beer and alcohol products, and some other entities.

Further, Article 14 provides that in the case where agricultural producers receive commercial credits relating to goods used for production, the value of such goods will be claimed as deductible on the date when the liability on the credit was settled. The creditor will include the value of goods to gross income in the period when the liability is to be settled according to the contract.

- Article 5 of the Profits Tax Law relating to quarterly variations of inventory and work in process is not applicable for agricultural producers.
- Item 8.1.3 of Article 8 of the Profits Tax Law allows that expenses for the purchase and fattening of productive cattle and growing of perennial fruitful plants are not depreciated and are deductible in full in the period when such expenses were incurred.

Finally, agricultural producers have a unique simplified scheme of taxation. Pursuant to the Law of Ukraine # 320-XIV of December 1998 "Concerning the Fixed Agricultural Tax", qualifying agricultural producers are subject to the special tax regime under a fixed agricultural tax. Qualifying taxpayers include legal entities and farmers with a share of gross income from the sale of agricultural products of own production and finished products produced from such agricultural products exceeding 50% of total gross income.

Annual amounts of fixed tax are based on the rates of fixed tax that were established based on tax as a percentage of the value of land. For example, the rate for arable land is 0.5% of the land value. The rate of fixed tax is increased by the coefficient 1.5 for the those taxpayers where the amount of taxes listed as payable in the year of 1997 exceeds by three to four times the amount of tax payable under a fixed tax regime, and by the coefficient 2.0 where such amount is exceeded by more that four times payable under a fixed tax regime. Tax is payable monthly according to an annual calculation. Taxpayers of the fixed tax are exempt from the following taxes:

- Profits tax (except for taxation of dividends and withholding tax);
- Land tax:
- Vehicle owners tax;
- Communal tax;
- Levy for geological works financed from the State Budget;
- Contributions to the Chernobyl Fund[9];
- Contributions for mandatory social insurance;

[9] Contributions to the Chernobyl Fund, Road Tax and Contributions to the Innovation Fund are not currently levied in Ukraine.

- Road tax (see footnote 1);
- Contributions for mandatory state pension insurance;
- Contributions to the State Innovation Fund (see footnote 1);
- Payments for trading patent;
- Levy for the use of natural resources (relating to the use of water).

All other taxes as established by the legislation of Ukraine are payable.

The fixed agricultural tax was introduced for the period from January 1, 1999 through January 2004. The Law stipulates that in the period from January 1, 1999 to January 1, 2001 the taxpayers qualifying for a fixed tax (under the simplified scheme of taxation) shall be exempt from a fixed agricultural tax. However, such taxpayers were not exempt from contributions for a mandatory social insurance (2% of the fixed tax) and contributions for the mandatory state pension insurance (68% of the fixed tax).

III.D Other Issues

There is a list of other issues that are frequently discussed with respect to tax policy in Ukraine. The first is the use of promissory notes, in particular by importers who are trying to delay the payment of VAT. The second is the establishment if transfer pricing rules, without which Ukraine stands to lose significant revenue to trading partners.

III.D.1 Promissory Notes

The issuance of promissory notes by importers in Ukraine is a common practice that is used to delay payment of VAT liability. This process is difficult to administer, and, given that the result is often the inability to collect the liability of the importer, costs the budget a significant amount of revenue. Further, this practice is unique to Ukraine, and not consistent with the 6th Directive of the European Union.[10]

Article 23 of the 6th Directive of the EU clearly states that member states may implement procedures to delay the payment of VAT liability by importers:

> *As regards imported goods, Member States shall lay down the detailed rules for the making of the declarations and payments.*
>
> *In particular, Member States may provide that the value added tax payable on importation of goods by taxable persons or persons liable to tax or certain categories of these two need not be paid at the time of importation, on condition that the tax is mentioned as such in a return to be submitted under Article 22 (4).*

Article 22 lays out the procedures for the filing of tax declarations. In particular, section 4 covers the information that should be required of the taxpayer by the member state:

> *Every taxable person shall submit a return within an interval to be determined by each Member State. This interval may not exceed two months following the end of each tax period. The tax period may be fixed by Member States as a month, two months, or a*

[10] Promissory notes do exist in other countries. In fact, Finland and Spain impose a Stamp Duty on the issuance of promissory notes (*European Taxation Database*, IBFD Publications, 2001, Release 4). What is unique to Ukraine in the use of promissory notes as a means to smooth transactions involving VAT imposed on imports.

quarter. However, Member States may fix different periods provided that these do not exceed a year

The return must set out all the information needed to calculate the tax that has become chargeable and the deductions to be made, including, where appropriate, and in so far as it seems necessary for the establishment of the tax basis, the total amount of the transactions relative to such tax and deductions, and the total amount of the exempted supplies.

In practice, what is done by most EU member states is that importers are allowed to forego payment of VAT at the border, and declare the liability on their tax declaration covering the current period. In this way, the importer is able to claim the liability and the same time that they claim VAT credits. At the time of importation, importers are generally required only to present a VAT invoice to the tax authorities. The invoice provides the information that is necessary to verify that the information of the VAT declaration is correct. This procedure is, in effect, what importers in Ukraine are attempting to replicate through the use of promissory notes.

Several member states, including Belgium, impose restrictions on the delay of VAT liability at the time of importation. These states impose certain qualification requirements, and taxpayers may only delay payment if authorized. Applicable conditions may include:

- Authorizing only taxpayers “in good standing”, meaning those that have established good relations with the tax authorities, file on time, and have committed no criminal offenses.
- Authorizing only large importers.
- Authorizing only importers for which imports represent a large percentage of their inputs to production.

It is important to note that such restrictions should be applicable to all taxpayers equally, and should not be imposed on selected groups of taxpayers without the approval of the Commission. For example, it would generally be unacceptable to impose specific rules targeting only businesses with foreign investors.

We recommend that Ukraine do away with the use of promissory notes for all transactions between importers and the tax authorities in Ukraine. A system of delayed payment based on VAT invoices will be easier to administer and improve VAT collections.

III.D.2 Transfer Pricing

Ukrainian tax legislation lacks a well-defined procedure for addressing transfer pricing issues. Current legislation addresses the issue of transfer pricing only in part. For example, a definition for “usual price” is provided for in article 1.20 of the EPT law – a definition that is also valid for VAT on basis of article 1.11 of the VAT law.

However, providing a definition in legislation is not sufficient to resolve the problem. There is a need for defining in legislation the methodologies determining how to define the usual price and how to re-assess correctly the value of transactions.

Transfer pricing methods, which are currently acceptable to most tax authorities, are based on the *arm’s length* principle. In non-technical terms, this principle means that a transaction should be valued at what company A would have charged company B in the market, if company B were an independent company not connected in any way with company A.

In applying the arm's-length principle to taxation, this means that when conditions are made or imposed between the two enterprises in their commercial or financial relations which differs from those which would be made between independent enterprises, then any profits accrued by either of the two enterprises as a result of those conditions should be included in the profits of that enterprise and taxed accordingly.

The International Accounting Standard IAS24, "Related Party Disclosures", refers to three methods. These are:

- The Comparable Uncontrolled Price (CUP) method, which defines an "uncontrolled price" through the application of statistical analysis of like transactions between like companies.
- The Resale Price method, which backs into the true market price by subtracting from the retail price the resale gross margin.
- The Cost-Plus method, which tabulates the costs of production, and then adds an appropriate markup.

Tax countries are increasingly using these *transactional methods* (CUP, resale price method and cost plus method) for transactions others than those that are occurring between Parent Company and related persons. For example, these methods can also be used:

- For barter transactions;
- For supply of goods, works and services free or partial free of charge, and the use by a taxpayer of goods forming part of his business assets for his private use or that of his staff, or more generally their application for purposes other than those of his business;
- For payment in kind for wages and salaries to employees and other remunerated persons of the taxpayer under employment and remuneration contract.

The use of the transactional methods where the level of contractual price stated by the parties fluctuates more than a well-defined percentage in either direction from the market price for identical/similar goods is more problematic, but is a very good tool for combating under- and over-valuations of transactions.

III.D.3 The Taxation of Raw Petroleum

A recent development in the relationship between Ukraine and the Russian Federation is the movement of Russia to the destination principle with respect to VAT. The change in legislation brings all exports to Ukraine in line with internationally accepted practice, except for oil. For oil exports, Russia has retained the principle of origin, and is depriving Ukraine of the tax revenue on its oil imports.

This issue has led to several proposals concerning the taxation of oil in Ukraine, and at least one proposal that currently has some momentum is to exempt all oil transactions from VAT, regardless of origin. The concern stems from the double application of VAT, first in Russia, and then again in Ukraine, leading to higher prices which will have a negative impact on economic growth. There is currently no analysis supporting or alleviating these concerns.

There are a number of options being considered, including:

- The application of a 20 percent rate on the import price, inclusive of Russian VAT;
- The application of a 20 percent rate on the import price, exclusive of Russian VAT;
- The zero-rating of imports of petroleum; and finally,

Table 4

Number of Entrepreneurs, 2001 (000s)

Type of Taxation	Legal Persons	Physical Persons	Total
Fixed Tax	-	295.9	**295.9**
Unified Tax	77.6	235.5	**313.1**
Special Patent	1.8	5.6	**7.4**
Total	**79.4**	**537.0**	**616.4**

- The exempting of a host of petroleum products, at all stages of production.

To be consistent with the 6th Directive of the EU, it is necessary to levy VAT on the customs value of the import, meaning inclusive of Russian VAT. To the extent that all raw oil is imported for purposes of intermediate consumption, there is no significant impact on the budget of zero-rating at the border. Exemption of petroleum products in general, while eliminating the double levy of VAT, is not likely feasible in the current budgetary environment.

III.D.4 Entrepreneurs and the Simplified Tax System

Ukraine's tax system comprises a wide range of national and local taxes and duties. Since 1999, Ukraine's small entrepreneurs — with up to UAH 500,000 in total revenues for physical persons, and up to UAH 1 million for legal entities — can opt out of the regular tax system and switch to a simplified taxation, under which a single tax replaces most of the principal taxes, including the enterprise profit tax and pension fund contributions. For physical persons, the single tax is assessed in the range of UAH 20 to 200 per month; for legal entities qualifying as small entrepreneurs, the simplified tax is 6 percent of total revenues, with the VAT paid separately, or 10 percent of total revenues and exemption from the VAT. The unified tax replaces some 16 different taxes and fees. The simplified tax scheme greatly reduces the record keeping and accounting requirements for small entrepreneurs.

At year-end 2001, the total number of taxpayers subject to the simplified taxation scheme comprised roughly 537,000 individual (physical persons) and 79,400 legal entities, as shown in Table 3. According to the data furnished by the State Committee for Regulator Policy and Entrepreneurship, the total number of non-agricultural small entrepreneurs has grown by over 50 percent between 2000 and 2001 (mid-year figures), to over 300,000 for the whole country. With two exceptions, all oblasts registered year-to-year changes around or above the national average; the one major exception is the Rivne oblast, which registered a significant decline in the number of registered small enterprises between 2000 and 2001. This anomaly is partly due to an unusually high participation in 2000 (five times the national average), and a campaign by local authorities to reduce this number, as reflected in a pattern of complaints reported in the press.

The failure of the PTC in its third reading was primarily the result of an uprising against its modifications to the system of small business taxation. Most significantly, the provisions in the new Tax Code require separate contributions to the pension and social insurance funds (accident insurance, unemployment insurance, and sick leave insurance). Since these two items account for some 57 percent of the total tax liability under the simplified taxation scheme, total payments would increase by more than half. In addition, these contributions are based on payroll records, implying a significant increase in tax accounting and reporting requirements.

IV Major Initiatives

Summary: *Major revisions of tax legislation are underway on two fronts. The current legislation is being revised, and the Proposed Tax Code is being reconsidered. These two efforts are taking place simultaneously and independently. While there is some consensus that new legislation will move forward on a tax-by-tax basis, there is some chance that the PTC will soon be considered by the Verkkhovna Rada. While many amendments have been proposed for the PTC for its third reading by the Cabinet of Ministers, the Government is hard at work redrafting the personal income tax and the rules for taxing physical persons under the simplified system of taxation. There is still debate as to whether the personal income tax should be based on a single tax or graduated rates and brackets.*

SEFR Position: *Ukraine needs a tax code. The government should focus its efforts on the revision of the tax code, ensuring that the resulting legislation is internally consistent and free of loopholes, taxes all Ukrainian-source income, and is revenue neutral when compared with existing legislation. A single rate for the personal income tax should be adopted to minimize administrative costs and reduce shadow activities. The qualification requirements that physical persons should satisfy to participate in the simplified system of taxation should be extended to include a criteria based on net income.*

Major legislative initiatives are underway on two fronts. Firstly, even though the Proposed Tax Code has lost considerable momentum, it is not yet dead. There are considerable resources being devoted within the Ministry of Finance to the redrafting of several parts of the Code. The ministry is working on the assumption of a 2004 implementation. On the other hand, the redrafting of current legislation is being given the priority, with the assumption that legislative changes are needed for the 2003 budget year.

IV.A The Proposed Tax Code

The adoption of a tax code in Ukraine is an essential step in the tax reform process. A tax code would ensure that consistent definitions and procedures are utilized for each of the various taxes that are paid by enterprises and individuals. In addition, a tax code would significantly improve the ability of the State Tax Administration to administer the tax laws in an equitable fashion and the ability of taxpayers to comply with the tax laws. By correcting many of the shortcomings of present law, a tax code would also reduce the need for the Government and the Verkhovna Rada to regularly amend the tax laws, which would provide much-needed stability to the tax system. Finally, by reducing tax privileges and increasing the non-taxable minimum income for the personal income tax, a tax code would dramatically improve the fairness of the tax system.

The most recent version of the PTC is far from perfect. It has both strengths and weaknesses, which are outlined below. While the PTC has many shortcomings, it can easily be improved to the point of being a strong foundation for the tax system of Ukraine. As a guideline, the most important principles are: reduced rates (to stimulate business activity), a broader base of tax (to improve fairness), and improved legislative language (to improve the ability of the State Tax Administration to administer the law and the ability of taxpayers to comply with the law).

IV.A.1 Why the Tax Code Is a Good Idea

The PTC represents a substantial improvement over current law. For this reason, the PTC has many supporters in Ukraine, including representatives from the President's office, the Cabinet of Ministers, the Verkhovna Rada, the STA, as well as from taxpayers. Different people support the PTC for different reasons, but the most important reasons for supporting the PTC are the following:

Simplification. The PTC would simplify the tax laws in Ukraine, which would have the beneficial effect of improving taxpayer compliance and the ability of the STA to administer the tax laws. First, the PTC would replace the current set of duplicative and often-contradictory tax laws and decrees with a single, unified law. The STA and taxpayers would be better able to locate and apply the relevant law. Second, the PTC would eliminate several relatively minor taxes, such as the Communal Tax and the Craft Tax, which generate minimal amounts of budget revenue but are costly for taxpayers to comply with. Third, the PTC would require the Enterprise Profit Tax declaration to be submitted to the STA annually, rather than quarterly, which would reduce costs for both taxpayers and the STA.

Fairness. The adoption of the PTC would improve the fairness of the tax system in Ukraine. The PTC would increase the amount of income of physical persons that is not subject to tax so as to more accurately reflect the minimum subsistence level in Ukraine. The amount of non-taxable income of physical persons would be increased to approximately 40% of *per capita* GDP, which is consistent with most Western countries and transitional countries (up from approximately 6% of *per capita* GDP under current law). In this way, the PTC is consistent with President Kuchma's initiative on poverty reduction. In addition, the PTC would improve the fairness of the tax system by taxing additional benefits, most investment income, and other types of income earned by "high income" taxpayers.

Economic efficiency. If adopted, the PTC would promote economic efficiency and long-term economic growth in Ukraine. The PTC would eliminate tax privileges for enterprises engaged in mining, metallurgy, electrical energy production, agriculture and housing construction. These privileges result in significant economic distortions by shifting resources (for example, workers and investment capital) away from their most productive use. While tax privileges may benefit specific taxpayers, the overall effect is to reduce the general welfare of the country. The additional budget revenue that will result from the elimination of tax privileges can be utilized to provide a lower EPT rate for all enterprises, thereby increasing after-tax profits and spurring additional investment and employment in Ukraine. The benefits of the PTC are significant. In many ways the PTC achieves most of the original objectives envisioned for the Tax Code—improved taxpayer compliance, a lower overall tax burden, and a more equitable and efficient tax system. For these reasons it is important to continue to support the development and passage of a Tax Code for Ukraine.

IV.A.2 Failures of the Current Draft

While the PTC is a major legislative undertaking with weighty objectives, it is not entirely successful in delivering the improvements that were initially expected. The PTC, as it currently stands, has the following major shortcomings:

Tax Avoidance. The PTC fails to address some common tax avoidance schemes. The tax laws should not be written in such a way as to allow well-advised taxpayers to avoid the payment of taxes that should be paid to the budget. For example, under the PTC, the Excise Taxes can be avoided be accepting notes or by deferring payment for excisable goods. As another example, the tax on business and investment income can be avoided by establishing companies in offshore zones. As a final example, the special tax system for small business can be exploited by artificially splitting businesses and by re-characterizing employees as entrepreneurs. These "loopholes" should be corrected in the PTC so as to ensure that each taxpayer pays an amount of tax to the budget that is commensurate with the profit or income derived by the taxpayer. Otherwise, taxpayers that are not able to take advantage of tax loopholes will rightfully view the tax system as unfair and will be less willing to voluntarily comply with the tax laws.

Ceding of Tax Revenues to Other Countries. The PTC cedes taxes properly payable in Ukraine to other countries. Under the PTC, persons engaged in business activities in Ukraine are not taxed in Ukraine on all income that is attributable to the business activity carried on in Ukraine. The rules in the PTC concerning the source of income are ambiguous and confusing, and are inconsistent with international practice. In addition, as in current law, the PTC does not contain a clear set of transfer pricing rules, which will result in taxpayers shifting profit or income to offshore zones that impose no tax or a minimal amount of tax on the profit or income. Ukraine faces significant budgetary constraints, and it cannot afford to relinquish revenue to which it is rightfully entitled to other countries.

Failure to fully recognize the special needs of small businesses. Chapter 98 of the PTC establishes the Special Regime of Taxation for small businesses, a system of taxation that provides little simplification over the standard system of taxation. Under current law, small businesses are able to pay a unified tax which substitutes for as many as sixteen different taxes and fees. Under the PTC, the Unified Tax substitutes for no more than four taxes. The small business would still be required to register for VAT, pay payroll taxes to various social funds, and pay other taxes and fees not explicitly included in the Simplified Regime. While there are certainly some small businesses that will accept the opportunity to reduce their liability by paying a flat 5% rate on turnover instead of Profits Tax, Personal Income Tax, Property Tax, and Market Fee, they would do this for reduced liability, rather than simplification. Such a system reduces payments into the budget, with no obvious benefits for the development of small businesses.

Ambiguous and Inconsistent Language. The language used in the PTC is ambiguous, opaque, and contradictory. If taxpayers cannot understand the law, then they will not be able to fully comply with the intent of the law. Furthermore, unclear and contradictory language will make the administration of the law both more difficult and more easily manipulated for corrupt purposes. As two examples, the terms "credit"[11] and "resident"[12] are ambiguous and inconsistent with international practice. Furthermore, the requirements regarding the submission of income tax declarations by physical persons are confusing and contradictory.

The failures of the PTC are primarily attributable to misdirected policy and careless drafting. Many of the problems can be rectified by adopting policies that are consistent with international practice and by exercising greater care in the drafting of the legislation.

---

[11] The term *credit* is defined in the PTC as "funds and tangible assets made available for a definite period and with requirement of interest payment." This definition is inconsistent with international practice. The PTC also invents new terminology to describe certain types of *credits*: "repayable financial assistance" and "non-repayable financial assistance". Such non-standard terminology decreases the transparency of the law and increases the cost of doing business in Ukraine.

[12] Under the PTC, a physical person is considered a resident of Ukraine if he or she resides in Ukraine for a period of at least 183 days during a year. There is no connection between the 183-day rule for residency and the taxable period. Consequently, a physical person who is physically present in Ukraine for at least 183 days during a year would be considered a resident of Ukraine for tax purposes for his or her entire life.

IV.A.3 Revenue Implications

The PTC includes substantial reductions in tax rates for all major taxes and eliminates some, but not all, tax privileges provided under current law. The net result is that the PTC as currently drafted will result in a substantial loss of revenue to the Consolidated Budget. For the first year that the PTC is effective, it is expected that tax revenues will be reduced by approximately 3.8 billion hryvnias.[13] In later years it will cost the Budget more than 5.6 billion hryvnias per year. These figures are subject to change as amendments adjust the proposed tax rates, tax privileges, and non-taxable minimum levels included in the PTC. Nevertheless, in order to avoid a serious budget crisis, it will be necessary to consider the elimination of additional tax privileges or a reduction of budget expenditures in connection with the enactment of the Tax Code.

As part of the consideration of the PTC, there has been considerable discussion about the potential for rapid growth in economic activity and budget revenues following the adoption of the PTC. It has been suggested that a reduction in tax rates will promote business development and encourage taxpayers to no longer operate as part of the shadow economy. While it is likely that the reduced tax rates will result in improved compliance and will positively impact budget revenues, it is prudent to assume that such changes will occur over a period of several years. There is no evidence from other countries, which would suggest that economic growth which results from a reduction in tax rates will come close to compensating for the initial loss of revenue. Thus, while the long-term loss of revenues may be smaller that the 5.6 billion hryvnias cited above, it is certainly closer to that figure than to zero.[14]

IV.A.4 Recommended Changes

The PTC can and should be improved. The following recommendations should be considered in order to achieve the objectives of European integration, improved transparency and compliance, and enhanced equity and efficiency. *Conform PTC to International Standards.* A person is more likely to invest in a country if the tax laws are familiar. Many transition countries have already recognized this fact and have achieved a much higher rate of foreign investment than Ukraine. The rules and definitions contained in the PTC should be modified so that they are more consistent with international practice. In addition, the PTC should eliminate all exempt transactions and zero-rated transactions under the VAT that are inconsistent with the 6th Directive of the European Union. The failure to conform the PTC to international standards will increase the cost of doing business in Ukraine with the result that many businesses will look elsewhere for investment opportunities.

Improve Clarity of Language. Clear and concise language is necessary both to improve taxpayer compliance and tax administration. The PTC should be amended to eliminate definitions and other rules that are not necessary for tax purposes. In addition, terms should be used consistently throughout the PTC. Finally, the PTC should simplify filing requirements and other rules applicable to less-sophisticated taxpayers.

Eliminate Tax Avoidance Schemes. The PTC should be amended to reform the Excise Taxes so as to make the tracking of excisable goods easier for the STA. The PTC should also treat the income of offshore companies as earned directly by Ukrainian owners. The PTC should treat related business as a single business in applying the small business rules and should prohibit employees from using the special system of taxation for small business.

---

[13] All figures are in 2002 hryvnias.

[14] Recent estimates suggest that as much as 10% of the lost revenue may be recovered during the first five years after the PTC is adopted.

Curtail Loss of Revenue to Other Countries. The PTC should be amended to curtail the loss of revenue to other countries that should rightly be paid to the Budget of Ukraine. The PTC should require all persons that are engaged in a business activity in Ukraine to pay tax in Ukraine on all income that is attributable to the business activity in Ukraine. Furthermore, the PTC should be amended to adopt appropriate transfer pricing rules to prevent the shifting of income to other countries.

Provide a valid, simplified alternative to small businesses. The development of a suitable system for taxing small businesses is not easy. Current legislation suffers from several major shortcomings, including the loss of budget revenues (as compared to the normal system of taxation), unequal treatment of taxpayers with similar levels of income, disincentive to grow and/or report income fully, cascading of VAT payments, increased cost of administration. The PTC eliminates many of these problems, but only at the cost of reduced simplification. An alternative system should be developed that provides more simplicity that the PTC, while at the same time providing more transparent integration into the normal system of taxation.

IV.A.5 Summary

The PTC represents a significant step forward in the reform of the tax system of Ukraine. The PTC will improve the fairness of the tax system and will contribute to a more efficient and productive economy. While much work remains to be done, the PTC will also set the stage for Ukraine's eventual integration into the European Union. Finally, the adoption of the PTC will be viewed by both foreign and domestic businesses as a sign that Ukraine is serious about creating a business environment that is transparent, equitable, and rewarding.

IV.B Legislation Currently under Development

Currently, all major taxes are being revisited with the intention of implementing improvements. Issues in the Enterprise Profits Tax include transfer pricing, the taxation of securities, and the treatment of off-shore zones. However, it is the Personal Income Tax that has been given the most attention, with the intention of presenting a revised draft first by June 2002.

IV.B.1 Personal Income Tax

Since the failure of the PTC to achieve its third reading in December 2001, the Ministry of Finance has begun investigating the possibility of reforming tax legislation on a tax-by-tax basis. The first tax to be addressed is the Personal Income Tax, which is currently being redrafted by the Department of Tax Policy and Macroeconomic Forecasting. To that end, the Ministry, in cooperation with the Secretariat of the Banking and Finance Committee of the Verkhovna Rada, have drafted an internal discussion memorandum "On the Reform of the Taxation of the Income of Physical Persons in Ukraine". This document is not always clear about whether it is discussing the Personal income Tax Law, or a package of legislation covering physical persons. Recent discussions with the Ministry suggest that the issue extends beyond the PIT to include the simplified forms of taxation as well.

As presented in the memorandum, the objectives of the Ministry are to draft legislation that will:

- Increase employment and job market development;
- Increase business income;
- Provide social support for the handicapped;

- Develop the social security system for “unprotected classes” of the population;
- Provide support for families with children.

These objectives should be accomplished within the constraints of:

- Raising sufficient budget revenues for financing state expenditures (note: the concept paper says “state” expenditures, but the PIT is currently allocated to sub-national governments);
- Stable economic growth; and
- Providing the stimulus for the legalization of physical person’s income.

To realize the objectives set forth, the new system of taxation should include the following characteristics:

- Transparency, the absence of contradictions, clarity, stability, the minimization of administrative costs;
- Equality (equal terms of taxation irrespective of profession affiliation);
- Generalization (note: this is roughly horizontal equity);
- Social fairness (note: perhaps something like vertical equity?)
- Redistribution of marginal rates (meaning to significantly change the rate structure so as to better allocate taxpayers across brackets).

The document has six sections discussing different areas of concern. Discussion within each section does not strictly adhere to the subject projected by the label. The sections are:

- *General Provisions.* This section defines several terms, including “taxpayer”, “gross income”, “adjusted gross income”, and the “gross expenses of the physical person”. The object of taxation to be gross income for the reported year reduced by the amount of the taxpayer’s expenses, originating in Ukraine.
- *Broadening of the Tax Base.* This section is devoted to the inclusion of the taxable base additional types of income, mostly resulting from real estate. At the same time, there is recognition of the need to protect individuals that live in their own apartments.
- *Rates of Taxation.* This section is devoted to the design of a set of rates of brackets, base on the broader definition of taxable income. It includes statement of the intent to equate the top bracket with the Enterprise Profits Tax, as well as discussion of withholding procedures.
- *Social Privileges.* This section suggests that the current non-taxable minimum be replaced by a system of tax credits to be awarded to “unprotected classes” of taxpayers. Other possible deduction could be granted to fund education and medical expenses. Also, there is discussion of a mortgage interest rate deduction.
- *Taxation of Entrepreneurs.* This section states the need to clearly define the terms of taxation of income from legal, accounting, notary public, and other independent professional activities.
- *Administration.* The concept paper proposes the taxation of income on a cumulative basis over the course of the year. It further established the need of indirect methods for the identification of undeclared income.

The concept paper has many strong points, and a few weak points. Overall, it recognized many of the concerns that have been raised by the foreign donor community, which will continue to support and monitor the drafting of the new legislation. It is, however, clear from recent discussions between Ministry of Finance staff and supporting institutes that there is significant disagreement, and that these guidelines remain quite fluid.

Apart from the structure of the new legislation, there is another debate that is ongoing: should Ukraine have a single rate or a progressive tax structure. Based on the Russian experience, there is considerable support for imposing a similar single-rate system in Ukraine. However, both the PTC and the Ministry's *Concept Paper* support a three-rate system, with rates ranging form 10 percent to 25 percent.[15]

Even though most Western countries impose a graduated system of tax rates in personal income, there are many widely respected reasons supporting a single tax. These include:

- *Reduced complexity.* All income is taxed at a single rate. There is little incentive to shift income from person to person or period to period in an attempt to find a lower marginal tax rate.
- *Political responsibility.* Graduated rates are often seen as the low-income majority imposing excessive tax burden on the high-income minority.
- *Increased economic growth.* Lower marginal tax rates are generally thought to increase the incentive to invest, thereby supporting economic growth.

The biggest reason against going to a single rate is that, for the low rates required to be socially acceptable, the single rate tax is perceived as having a significant negative impact on budget revenues.

This perception that budget revenues would be devastated by a single rate is somewhat justified. Including a non-taxable minimum consistent with the low-income protection included in the PTC, a single rate of 12.5 percent would reduce budget revenues from the PIT by over 50 percent. However, the graduated rates included in the PTC have a similar revenue impact.[16] As any change in PIT legislation is likely to provide a substantial increase in protection given to low-income individuals, the revenue costs of reforming the PIT is likely to be very high regardless of the rates and brackets.[17]

Thus the choice of a single rate over a graduated system comes down to weighing the issues of administration and economic growth against Ukraine's standards for fairness and equitability. Given that Ukraine is in need of substantial improvements in administration and business development, a single rate would seem to be the better choice, assuming an appropriately chosen system for supporting the low-income population.

However, it is necessary to emphasize that the costs to the budget (in this case local budgets) will be substantial. Alternative sources of revenue will be required to replace lost PIT collections. Further, the fact that such a system can be expected to spur economic growth should not be understood to mean that the growth would be immediate or unbounded. While growth may be measurable an significant over the following five years, in no way would it ever come close to replacing the lost revenue resulting from the lowered tax burden.

[15] The *Concept Paper* has annual rates of 10, 15 and 25 percent imposed on brackets of UAH 0-4,800, 4,800-24,000, 24,000 and up. The PTC has the same rates imposed on brackets of UAH 0-7,200, 7,200-72,000, 24,000 and up. Both include low-income tax credits of UAH 72 and 144, respectively.

[16] Based on SEFR estimates.

[17] On the other hand, much of the "over-performance" of the PIT in recent years has been the result of increasing average wages resulting from nominal economic growth. Giving up the system of multiple brackets will result in giving up what is currently Ukraine best-performing tax feature.

IV.B.2 The Taxation of Physical Persons under the Simplified Tax

The focus on the Personal Income Tax has recently broadened into a more general discussion of the taxation of physical persons. The rapid growth of the number of entrepreneurs emphasizes the need to reform the system of simplified taxation in a way that is consistent with the reform of the PIT. Within the Ministry of Finance, the same group that is redrafting the PIT is investigating proposed adjustments to the regime of simplified taxation.

Net income of individual entrepreneurs is subject to personal income tax that is assessed based on the standard system's graduated scale of rates that are both applicable in Ukraine to employment income and income derived from individual entrepreneurial activity[18]. The rates that are applicable currently in Ukraine are defined by the Presidential Edict #519/94 dated September 13, 1994 (as amended) and are expressed in multiples of non-taxable minimums. A non-taxable minimum is currently UAH 17.

As an example of the highest tax rate, a monthly income in excess of 100 non-taxable minimums (over UAH 1,700) is taxed in the amount of UAH 393.55 plus 40% of the income exceeding UAH 1,700. Net income is defined as the difference between sales income and expenses under separate instructions of the Tax Administration that are in some cases not identical with regulations defining deductible expenses of legal entities.

In addition to the regular set of taxes, there are several options available to individual entrepreneurs regarding their choice of tax regime. These options include:

- A simplified system of taxation with the payment of a *single tax (*aka *uniform tax)*;
- The payment of a *fixed tax*; and
- The *Special Trade Patent*.

The single tax is available to those entrepreneurs who satisfy a number of criteria, including:

- Annual turnover not exceeding UAH 500,000;
- The number of employees employed by the entrepreneur should not exceed 10 persons;
- The entrepreneur should not engage in the trade of alcoholic beverages, tobacco, and/or fuel lubricants.

Private entrepreneurs qualifying for the simplified tax regime with payment of a single tax are exempt from a number of national and local taxes including: personal income tax; VAT, land tax, payroll contributions including contributions to the Pension Fund, Social Security Fund, Unemployment Fund, and the payment for the use of natural resources.

The State Treasury splits the amounts of single tax paid by the entrepreneur in the following proportions: State Budget-20%; Local Budget-23%; Pension Fund-42%; Social Security Fund and Unemployment Fund-15%. The single tax is payable monthly. The amount of the single tax is established by the local authorities for different types of activities and may be established within the limit ranging from UAH 20 to UAH 200 per month. In cases where the private entrepreneur uses hired labor, the amount of fixed tax is increased by 50% for each employee.

[18] Decree of the Cabinet of Ministers # 13-92 dated December 26, 1992 "Concerning Personal Income Tax"

Private entrepreneurs trading in the markets with payment of the market levy (local tax not exceeding 20% of one non-taxable minimum-UAH 17) may choose to pay a fixed tax. To qualify for the fixed tax, an entrepreneur must have:

- Gross income for the previous 12 months not exceeding 7,000 non-taxable minimums (currently this amounts to UAH 119,000);
- Not more than 5 employees;
- No trade in alcoholic beverages or tobacco..

The monthly amounts of fixed tax are established by the local authorities to be between the limits of UAH 20 to 100 UAH. In cases where the private entrepreneur uses hired labor, the amount of fixed tax is increased by 50% for each employee. Private entrepreneurs under a fixed tax regime are exempt from a number of taxes including personal income tax on income derived under a fixed tax regime; VAT, payroll contributions including contributions to the Pension Fund, Social Security fund, and the Unemployment Fund.

Private entrepreneurs trading for cash from outlets or providing consumer services may choose to obtain special patents that entitle them to taxation under a special patent regime. The local state authorities define a monthly payment for a special patent. Special patent regime is currently applied in Ukraine as an experiment in a 16 cities and small districts of Ukraine. Entrepreneurs under a special patent regime are exempt from personal income tax applicable to activity under a special patent regime, VAT, land tax, as well as payroll contributions to the Pension Fund and Social Insurance Fund.

There is currently discussion amongst government officials regarding the taxation of physical persons under these special regimes. Concern about lost revenue from entrepreneurs using the simplified system to significantly lower their tax burden. The most notable example would be entrepreneurs selling consulting services for significant fees at near-zero costs. The simplified system was not designed to provide tax shelter to these entrepreneurs, but rather, to simplify the accounting for small enterprises. A proposal that is currently being discussed defines a change to legislation that would require entrepreneurs that are physical persons to be taxed as legal persons under the simplified schemes of taxation. This is a somewhat vague proposal that raises many questions.

Under current law, small- and medium-sized businesses that are registered as legal persons may opt to pay a single tax under the simplified taxation system. To qualify for the single tax, the legal entity should comply with the following criteria:

- Annual turnover should not to exceed UAH 1,000,000;
- The number of employees as employed by the legal entity should not exceed 50 persons.

The legal entity may choose to pay VAT, in which case the rate of 6% as applied to gross sales turnover. If the legal entity chooses not to pay VAT, liability is 10% of gross sales turnover. Legal persons being taxed under the simplified tax regime with payment of a single tax are exempt from a number of national and local taxes including corporate profits tax, land, as well as payroll contributions including contributions to the Pension Fund, Social Security Fund, and Unemployment Fund.

The decision to tax physical persons as legal persons would result in two scenarios:

1. An individual entrepreneur currently paying a single tax or a fixed tax may be taxed under the single tax regime as applicable under a simplified tax system for legal entities, or under the standard tax regime as applied to legal entities.

2. An individual entrepreneur paying an income tax under the standard system of personal income tax may fall under a single tax regime as applicable under a simplified tax system or under the standard tax regime as applied to legal entities.

Under first scenario, the choice by the private entrepreneur to pay the single tax as applied to legal entity could mean a significant increase in tax payable by the entrepreneur, as the rate of tax would reach 10% of the sales turnover (in case where VAT is not paid) compared to maximum of UAH 200 per month. Further, the application of the standard tax regime, including the payment of profits tax (30%) would mean that entrepreneurs with a net monthly income over UAH 666 would pay income tax in amounts exceeding UAH 200. Such entrepreneurs would be subject to other taxes and fees, including VAT and a number of payroll contributions.

Under the second scenario, the entrepreneur choosing the single tax regime as applicable under a simplified tax system for legal entities will see an increase or decrease in liability depending on the net income margin and amounts paid by the entrepreneurs as payroll contributions to social funds. The entrepreneur would likely only choose the simplified system in the event that it will reduce his liability.

However, under the second scenario the individual entrepreneur would not be able to claim any tax benefits as such benefits may be claimed by the taxpayers of the personal income tax and are outside the scope of the tax regime as applied to legal entities. Currently such benefits include the entitlements of the taxpayer to decrease the amount of taxable income tax up to 10 non-taxable minimums (in total UAH 170) based on the status of the taxpayer as a Chernobyl disaster victim, invalid, war veteran, etc.

In addition to the determination of liability, there are other considerations when considering the taxation of physical persons as legal persons. Individual entrepreneurs paying a single tax or a fixed tax are not required by the legislation to use cash registers (subject to certain conditions) and are subject to simplified reporting requirements. They need not maintain sets of accounting records as required for legal entities. The introduction of a taxation regime similar to that for legal entities (at least for those individuals paying tax under the standard regime for legal entities) would inevitably be followed by accounting and reporting requirements similar to those for legal entities.

While the taxation of entrepreneurs as legal persons could potentially result in an increase in revenues into the budget, it would do so at the cost of lost simplicity. Most Western Countries allow private individuals to engage in entrepreneurial activity and pay tax on their net income through the normal personal income tax. This is currently true in Ukraine, and should be continued in the future.

The application of the simplified system of taxation for legal persons to entrepreneurs would require a substantial increase in administrative burden for the taxpayer. For this reason it is appropriate to continue the current system of taxing physical persons under a simplified regime. However, to minimize revenue loss, it is appropriate to eliminate from the pool of entrepreneurs those with excessive net income. To do this, it would be advisable to include in the legislation additional criteria for qualification based on maximum allowed net income, as calculated according to a simplified set of accounting rules. Such a change in legislation could be used to eliminate from the tax base of the simplified system those entrepreneurs that are selling consulting services for high fees and low costs, while still allowing legitimate small businesses earning normal margins to continue under the current system.

V Policy Priorities for Tax Reform

Tax policy in Ukraine has not spent much time standing still. Modern versions of the VAT and EPT were adopted five years ago, but the countless number of amendments has masked many of the stronger features those laws had to offer. As Ukraine moves into the next phase of reform, particular emphasis should be placed on making the correct choices in four policy areas:

- *Rate Reductions.* There is considerable pressure being place on the Government of Ukraine by the Verkhovna Rada to reduce the marginal rates of taxation of all major taxes. The proponents of these rate reductions say that they are necessary to stimulate economic growth, foreign investment, and bring activity out of the shadow sector. All of these arguments have some validity. However, the revenue cost of the rate reductions is extremely concerning. The rate reductions included in the latest version of the Proposed Tax Code stand to cost the budget over 7.5 billion UAH, or approximately 23% of total tax revenues. For this reason it is necessary to reduce rates where they will have the most impact. Direct tax rate reductions are more likely to enhance economic growth than reductions in the indirect taxes.
- *Base Broadening.* The expansion of the tax bases is essential. The recent standoff between the Government of Ukraine and the IMF resulted from the fact that VAT base has shrunk to the point where the tax no longer raises sufficient revenue to fund its own refunds. The PTC is a major revenue loser because it fails to sufficiently expend the base to the point that the proposed rate reductions are revenue neutral. The trend towards giving special tax treatment to all sectors of production must be reversed.
- *Payroll Taxes.* Social taxes in Ukraine are significant, and are due for reform. Payroll tax rates are very high (totaling 42%), although the ceilings are not excessive. There is strong pressure to reduce the payroll tax rates, but the issue is being raised at a time when pension outlays are due to increase by 10% (July 1st). There is clearly a need to reform the payroll tax system, although this discussion has been avoided in the tax reform debate. The PTC does not address the issue of payroll taxes.
- *Simplified System of Taxation.* The PTC failed to be adopted in the third reading in part because the system of simplified taxation included in the draft was deemed excessively burdensome on small taxpayers. The PTS significantly reduces the amount of simplicity gained by participating in the simplified system, and would deal most small businesses with a significant increase in liability. While the current simplified system is considered to result in significant loss of revenue to the budget, there is certainly a place for a simplified system. There is a need to reform the simplified system to minimize the sheltering of taxable income, while providing a legitimately simplified system that will foster business development in what is likely to be a very dynamic business sector.

There are clearly many other issues that need to be addressed before the tax reform process in Ukraine can be considered approaching completion. Should the Government of Ukraine, along with the newly elected Rada move forward on the issues raised in this section, the goal of a modern, efficient tax system in Ukraine will again be two steps closer.

Annex A Legislative Changes in 2001

This annex summarizes basic legislative amendments that took place during the year of 2001 by the types of taxes.

A.A Corporate profits tax

The corporate tax is regulated by the Law of Ukraine #283/97 of May 22, 1997 'Concerning Profits Tax of Enterprises" (profits tax law). During the year of 2001 the following laws introduced a number of amendments to the profits tax law:

1. Law #2211-III of January 11, 2001;
2. Law #2323-III of March 22, 2001;
3. Law #2355-III of April 5, 2001;
4. Law #2406-III of May 17, 2001;
5. Law #2410-III of May 17, 2001;
6. Law #2711-III of September 20, 2001;
7. Law #2712-III of September 20, 2001;
8. Law #2744-III of November 4, 2001;
9. Law #2779-III of November 15, 2001;
10. Law #2831-III of November 29, 2001;
11. Law #2866-III of November 29, 2001;
12. Law #2905-III of December 20, 2001

The Law #2211-III " Concerning Recognition of the Armored Vehicles Industry as a Priority Industry and Measures for the State Support of the Industry" introduced for a period from January 1, 2001 to January 1, 2006 a procedure whereby taxable income for profits tax purposes shall be defined by the companies of the concern "Armored vehicles of Ukraine" on shipment of vehicles and car components produced under state orders or international contracts. Under the general practice, a first event rule is applied where the taxable income is defined on either the receipt of payment or shipment of goods depending on which event takes place first.

Further the Law stipulated that the tax liability of the concern "Armored Vehicles of Ukraine" relating to the State Budget as per January 1, 2001 shall be spread out for 60 months and this liability is to be settled in equal portions staring from January 1, 2001.

Pursuant to the Law, the Cabinet of Ministers shall define a list of companies that will fall under the above taxation regime.

The Law #2323-III "Concerning Amendments to Certain Tax Laws of Ukraine in Connection with the Establishment of the Free Economic Zone " Mikolaiv" stipulated that profits of the enterprises established in the free economic zone "Mikolaiv" are to be taxed under the special regime as established by the Law of Ukraine "Concerning the Special Economic Zone "Mikolaiv".

The Law #2355-III "Concerning Amendments to Certain Tax Laws of Ukraine in Connection with Introduction of the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast" stipulated that the profits of the entities realizing investment projects on the territory of priority development in Volyn Oblast shall be taxed according to the Law of Ukraine "Concerning the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast".

The Law #2406-III "Concerning the Confirmation on Compliance" added an amendment to the profits tax law stating that the expenses incurred in connection with certification of product quality, product quality control systems, quality management systems, environmental control systems, and personnel management systems as required by the Law #2406-III shall be deductible for corporate profits tax purposes.

The Law #2410-III "Concerning Amendments to Certain Tax Laws of Ukraine" as effective from June 1, 2001 stipulated that income from the sale of published products directly to clients or consumers shall not be subject to profits tax. The Law also provided that expenses incurred in producing such products shall not be deductible.

The Law #2711-III "Concerning Amendments to Sub Article 22.3 of Article 22 of the Law of Ukraine" 'Concerning Profits Tax of Enterprises" introduced amendments whereby 1.5% of the profits tax paid in the period to January 1, 2006 shall be directed by the Treasury to the special accounts of local authorities (at oblast level). These funds shall be used to build or purchase houses and apartments for military servants, participants of wars in Afghanistan and other regions, members of their families, etc.

Previous version of Article 22 stated that 1.5% of the profits tax revenue shall be used for these purposes in the period to January 1, 2002.

The Law #2712-III "Concerning Amendments to the Law of Ukraine "Concerning Profits Tax of Enterprises" as effective from January 1, 2001 introduced depreciation rates for oil and gas wells and stipulated that exploration expenses shall be deductible except for certain types of expenses (to be defined by the Cabinet of Ministers) that are to be capitalized. Previously, expenses related to extraction of deposits were capitalized and depreciated according to special formula.

The Law #2744-III "Concerning Amendments to Certain Tax Laws of Ukraine" incorporated into the profits tax law the provisions of the special taxation regime for technological park "Vuglemash" in Donetsk. Under this regime the amounts of profits tax accrued are to be accumulated on special accounts and used by "Vuglemash" for scientific and technological research and development.

The Law #2779-III "Concerning Amendments to Certain Legislatives Acts of Ukraine Relating to the State Support for Automobile Industry of Ukraine" introduced amendments to the Law of Ukraine "Concerning the Stimulation of Automobile Production in Ukraine". As a result, the Law provided for an amendment to the profits tax law whereby special taxation regime is to be applied to companies qualifying under the amended law "Concerning the Stimulation of Automobile Production in Ukraine".

The amended law "Concerning the Stimulation of Automobile Production in Ukraine" introduced additional qualifying investment limit of USD 30 mln. for truck and bus producers and USD 10 mln. for producers of car components.

The Law #2831 "Concerning Amendments to Certain Tax Laws of Ukraine" introduced a number of definitions relating to issue of securities, dividends and mutual investment funds.

The Law #2866-III "Concerning Association of the Co-owners of Apartment Block" introduced into corporate profits tax law a definition of association of co-owners of apartment block as a non-profit organization for corporate tax purposes.

The Law #2905-III "Concerning the State Budget of Ukraine for the year of 2002" suspended for the calendar year of 2002 Article 17 of the Law of Ukraine 'Concerning Profits Tax of Enterprises". Pursuant to Article 17, profits tax was to be paid to the budget of local communities on the territory where the taxpayer was located.

Further, Article 7 of the Law #2905 stipulated that the fixed assets of the group II and group III are not to be depreciated for taxation purposes in cases where such assets are put out of operation. However, the Law #2905 did not introduce amendments into the profits tax law with this regard and, as a result, this lead to a contradiction between requirements of the Law #2905 and the profits tax law. The profits tax law provides that taxation of profits shall be regulated exclusively by the profits tax law.

A.B Value-added tax

The value-added tax is regulated by the Law of Ukraine #168/97-VR of April 3, 1997 'Concerning Value-added Tax" (VAT law). During the year of 2001 the following laws introduced a number of amendments to the VAT law:

1. Law #2211-III of January 11, 2001;
2. Law #2233-III of January 18, 2001;
3. Law #2323-III of March 22, 2001;
4. Law #2355-III of April 5, 2001;
5. Law #2410-III of May 17, 2001;
6. Law #2649-III of July 11, 2001;
7. Law #2660-III of July12, 2001;
8. Law #2744-III of October 4, 2001;
9. Law #2779-III of November 15, 2001;
10. Law #2831-III of November 29, 2001;
11. Law #2899-III of December 20,2001;
12. Law #2905-III of December 20, 2001.

Further to the amendments of the profits tax law as mentioned above, the **Law #2211-**III " Concerning Recognition of the Armored Vehicles Industry as A Priority Industry and Measures for the State Support of the Industry" introduced amendments to the VAT law that will be effective from January 1, 2001 to January 1, 2006.

Pursuant to these amendments, imports of materials, components and equipment used for producing armored vehicles shall not be subject to import VAT as per the list approved by the Cabinet of Ministers.

Sale of goods and services to the concern “Armored Vehicles of Ukraine” and sale of armored vehicles under the state orders and international contracts shall be subject to VAT at zero rate.

The Law #2233-III “Concerning Amendments to the Law of Ukraine ‘Concerning the Value-Added Tax” extended from January 1, 2001 to January 4, 2004 the procedure whereby qualifying agricultural producers (with a share of gross income from the sale of agricultural products of own production and finished products produced from such agricultural products exceeding 50% of total gross income) shall be entitled to use the amounts of VAT accrued on special accounts for purchasing production supplies.

The Law #2323-III “ Concerning Amendments to Certain Tax Laws of Ukraine in Connection with the Establishment of the Free Economic Zone “ Mikolaiv” stipulated that qualifying entities in the free economic zone “Mikolaiv” shall charge VAT under the special regime as established by the Law of Ukraine “Concerning the Special Economic Zone “Mikolaiv”.

This provision was passed according the accepted practice in Ukraine in order to apply a special regime of VAT for enterprises located in free economic zones.

Similar to the amendments to the profits tax law, the **Law #2355-III** “Concerning Amendments to Certain Tax Laws of Ukraine in Connection with Introduction of the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast” stipulated that VAT shall be applied to goods shipped to the territory of priority development in Volyn Oblast under the taxation regime as defined by the Law of Ukraine “Concerning the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast”.

The Law #2410-III “Concerning Amendments to Certain Tax Laws of Ukraine” coming into effect June 1, 2001 amended the VAT law to the effect that import of certain goods (as listed in Sub Article 19 “O” of the “Single Customs Tariff) used for production of published products shall be exempt from import VAT during the period from June 1, 2001 to January 1, 2003.

The Law #2649-III “Concerning Amendments to Article 11 of the Law of Ukraine “Concerning Value-Added Tax” stipulated in the amendments that pending the introduction of the Tax Code taxpayers selling thermal energy, gas (excluding liquid gas) and communal services provided to individuals, budget institutions and housing service entities (zheks) shall define tax base for VAT purposes based on cash basis.

The Law #2660-III “Concerning the State Support for Aircraft Construction Industry in Ukraine” introduced amendments to the VAT law whereby during the period from January 1, 2000 to January 1, 2007 certain companies involved in aircraft construction shall be exempt from import VAT on purchases of imported materials, components and equipment as per list to be defined by the Cabinet of Ministers. The sale of aircraft produced within funding from the State Budget shall be subject to VAT at zero rate.

The Law #2744-III “Concerning Amendments to Certain Tax Laws of Ukraine” incorporated into the VAT law the provisions of the special taxation regime for technological park “Vuglemash” in Donetsk. Under this regime VAT payments are to be accumulated into special accounts and used by “Vuglemash” for scientific and technological research and development.

The Law #2779-III "Concerning Amendments to Certain Legislative Acts of Ukraine Relating to State Support for Automobile Industry of Ukraine" introduced amendments to the Law of Ukraine "Concerning the Stimulation of Automobile Production in Ukraine". This amended law introduced an additional qualifying investment limit of USD 30 million for trucks and bus producers and USD 10 mln. for producers of car components.

Further, the amendments were also introduced into the to VAT law whereby the companies qualifying under the amended law "Concerning the Stimulation of Automobile Production in Ukraine" shall be exempt from import VAT on import of car components. Sale of cars, buses and components shall be zero rated for VAT purposes in the period to January 1, 2008.

The Law #2831 "Concerning Amendments to Certain Tax Laws of Ukraine" defined the activity on management of assets as activity that is not subject to VAT.

The Law #2899-III "Concerning Amendments to Certain Laws of Ukraine in Order to Eliminate the Cases of Tax Evasion by Certain Enterprises with Foreign Investment" introduced amendments to the VAT law stipulating that business entities with foreign investment may be considered VAT taxpayers regardless of the period when the foreign investment was made and legal form of investment.

Further, the amendments provide that enterprises with foreign investment shall not be entitled to use promissory notes for payment of import VAT.

The Law #2905-III "Concerning the State Budget of Ukraine for the Year of 2002" incorporated into VAT law an amendment whereby the services on transit transportation of goods and passengers via the territory of Ukraine shall be subject in the period to January 1, 2003 to same VAT regime that was applied in the year of 2001.

Further, the Law #2905 provided that input VAT on goods and services that are exported under barter contracts shall not be claimed as VAT credit and shall be included into gross expenses. Similar provisions were also included into budget laws during the previous years.

A.C Personal Income Tax

The personal income is regulated by the Decree of Cabinet of Ministers of Ukraine #13-92 of December 26, 1992 "Concerning the Personal Income Tax". The following laws enacted amendments to the Decree during the year of 2001:

1. Law #2405-III of April 26, 2001;
2. Law #2831-III of November 2001;
3. Law #2905-III of December 2001.

The Law #2405 "Concerning Amendments to Article 5 of the Decree of the Cabinet of Ministers "Concerning Personal Income Tax" stipulated that the amounts of aid and gifts/presents granted to the individual once per year within the limits of the official subsistence level shall not be included into taxable income for personal income tax purposes. The Law also stated that certain items of income are not to be included into the taxable base for payroll contributions.

The Law #2831 "Concerning Amendments to Certain Tax Laws of Ukraine" reworded the provision of the Decree relating to taxation of gains on sale of securities.

The Law #2905-III “Concerning the State Budget of Ukraine for the Year of 2002” incorporated into the Decree a number of amendments relating to administration of the personal income tax in order to bring the Decree on line with other basis tax laws relating to administration of taxes.

A.D Land tax

The land tax is regulated by the Law of Ukraine #2535-XII of July 3, 1992 “Concerning Payment for Land” (land tax law). The following law enacted amendment to the land tax law during the year of 2001:

1. Law #2211-III of January 11, 2001;
2. Law #2271-III of February 8, 2001;
3. Law #2323-III of March 22, 2001;
4. Law #2660-III of July 12, 2001;
5. Law #2779-III of November 15, 2001;
6. Law #2905-III of December 20, 2001.

The Law #2211-III “Concerning Recognition of the Armored Vehicles Industry as a Priority Industry and Measures for the State Support of the Industry” introduced from January 1, 2001 to January 1, 2006 tax exemption from land tax for enterprises of the concern “Armored vehicles of Ukraine” as per the list to be defined by the Cabinet of the Ministers of Ukraine.

The Law #2271 “Concerning Amendments to the Law of Ukraine “Concerning Payment for Land” introduced amendments to the land tax law to include owners of land plots which became entitled to the land during the land reform in Ukraine in sphere of the land tax law.

The Law #2323-III “Concerning Amendments to Certain Tax Laws of Ukraine in Connection with the Establishment of the Free Economic Zone “Mikolaiv” incorporated into the land tax law a provision stipulating that enterprises realizing investment projects in the free economic zone “Mikolaiv” are to be exempt from the land tax on the territory of special economic “Mikolaiv”.

The Law #2660-III “Concerning the State Support for Aircraft Construction Industry in Ukraine” introduced amendments to land tax law providing exemption from the land tax to a number of aircraft construction companies during the period from January 1,2002 to January 1, 2007.

The Law #2779-III “Concerning Amendments to Certain Legislative Acts of Ukraine Relating to State Support for Automobile Industry of Ukraine” introduced amendments to the land tax law providing in the period to January 1, 2008 an exemption from the land tax to those entities that qualify under the amended law “Concerning the Stimulation of Automobile Production in Ukraine”

The Law #2905-III “Concerning the State Budget of Ukraine for the Year of 2002” incorporated into the land tax law a number of minor amendments relating to administration of tax.

Further, the Budget Law defined the index for the year of 2002 that is to be applied for land tax calculation in cases where the land is not valued according to the established procedure.

A.E Excise duty

Excise duty is regulated by the Decree of the Cabinet of Ministers of Ukraine #18-92 of December 1992 "Concerning Excise Duty" (excise duty decree). As the Decree does not establish the rates of the excises duty, rates for excisable products are established by a number of separate laws. The following laws enacted amendment to the excise duty decree during the year of 2001:

1. Law #2324-III of March 22, 2001;
2. Law #2895-III of December 13, 2001.

The Law #2324-III "Concerning Amendments to the Decree of the Cabinet of Ministers of Ukraine "Concerning Excise Duty" introduced a number of amendments to the excise duty decree relating to the definition of the excise duty, taxpayers of the excise duty, taxable event relating to excise duty, payment of excise duty on transactions involving toll processing of raw materials.

The Law #2895-III "Concerning Amendments to the Decree of the Cabinet of Ministers of Ukraine "Concerning Excise Duty" introduced into the Decree a definition of the toll processing transaction and toll processing arrangement.

There were no amendments relating to the rates of excise duty.

A.F Customs duty

The customs duty is regulated by the Law of Ukraine #2092-XII of February 1992 "Concerning the Single Customs Tariff" (customs tariff law).

The following laws enacted amendment to the customs tariff law during the year of 2001:

1. Law #2211-III of January 11, 2001;
2. Law #2323-III of March 22, 2001;
3. Law #2355-III of April 5, 2001;
4. Law #2410 of May 17, 2001;
5. Law #2660-III of July 12, 2001;
6. Law #2744-III of October 4, 2001;
7. Law #2751-III of October 4, 2001;
8. Law #2888-III of December 13, 2001.

The Law #2211-III "Concerning Recognition of the Armored Vehicles Industry as a Priority Industry and Measures for the State Support of the Industry" provided to the companies of the concern "Armored Vehicles of Ukraine" an exemption from the customs duty on materials, components and equipment imported for production needs during the period the period from January 1, 2001 to January 1, 2006. The list of items falling under exemption is to be defined by the Cabinet of Ministers.

The Law #2323-III "Concerning Amendments to Certain Tax Laws of Ukraine in Connection with the Establishment of the Free Economic Zone " Mikolaiv" stipulated that export and import customs duty for entities in the free economic zone "Mikolaiv" shall be levied under the special regime as established by the Law of Ukraine "Concerning the Special Economic Zone "Mikolaiv".

The Law #2355-III "Concerning Amendments to Certain Tax Laws of Ukraine in Connection with Introduction of the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast" provided that import customs duty related to import of goods to the territory of priority development in Volyn Oblast shall be levied according to the Law of Ukraine "Concerning the Special Regime of Investment Activity on the Territory of Priority Development in Volyn Oblast".

The Law #2410-III "Concerning Amendments to Certain Tax Laws of Ukraine" as effective from June 1, 2001 provided an exemption from import customs duty on a number of goods used as inputs for production of published products.

The Law #2660-III "Concerning the State Support for Aircraft Construction Industry in Ukraine" provided to a number of aircraft construction companies an exemption from import customs duty relating to import of materials, components and equipment during the period from January 1, 2002 to January 1, 2007.

The Law 2744-III "Concerning Amendments to Certain Tax Law of Ukraine" provided to technological park "Vuglemash" in Donetsk an exemption from import customs duty.

The Law #2751-III "Concerning Amendments to Article 19 of the Single Customs Tariff" excluded paints falling under code 3208 from items that are exempt from an import customs duty.

The Law #2888-III "Concerning Amendments to the Law of Ukraine "Concerning National Fund of Archives and Archives Institutions" amended the customs tariff law to the effect that import of documents to the national archives fund shall not be subject to import customs duty.

It is worth noting that the Law of Ukraine #2371 of April 5, 2001 "Concerning Customs Tariff" introduced a systematized list of customs duty rates based on the Ukrainian system of classification of goods involved in foreign economic activity.

A.G State duty

The state duty is regulated by the Decree of the Cabinet of Ministers of Ukraine #7-93 of January 21, 1993 "Concerning the State Duty". This Decree was amended during the year of 2001 by the following laws:

1. Law #2368-III of April 5, 2001;
2. Law #2785-III of November 15, 2001.

The Law #2368-III "Concerning Amendments to the Decree of the Cabinet of Ministers of Ukraine "Concerning the State Duty" stipulated that Audit Chamber of Verhovna Rada shall not liable to pay state duty on the applications to the Highest Arbitration Court of Ukraine.

The Law #2783-III "Concerning Amendments to the Decree of the Cabinet of Ministers of Ukraine "Concerning the State Duty" introduced a state duty for the issue of patents and certificates verifying intellectual property rights and defined the amount of state duty payable depending on the type of such patents and certificates.

A.H Contributions to the social funds

During the year of 2001 a number of amendments took place relating to the laws regulating contributions to the social funds. The laws that affected these amendments include:

1. The Law #2213-III of January 11, 2001;
2. The Law #2272-III of February 22, 2001;
3. The Law #2452-III of May 24, 2001;

The Law #2213-III "Concerning the Rates of Contributions for Certain Types of Mandatory State Social Insurance" redefined the rates of contributions for social insurance relating to Social Insurance Fund and Unemployment Fund. The Law introduced a new provision whereby the costs of sick leave payments for the first five days are to be borne by the employer.

The Law #2272 –III "Concerning the Insurance Tariffs for Mandatory State Insurance Relating to Industrial Accidents" introduced rates for contributions relating to industrial accidents insurance. Such contributions started to be payable from April 1, 2001.

The Law #2452-III "Concerning Amendments to the Law of Ukraine "Concerning Contributions for Mandatory State Pension Insurance established fixed amounts in UAH payable as contribution to the Pension Fund for the sale of 1,000 cigarettes. Prior to the amendments, contributions were established as a percentage (5%) of the cigarettes sales turnover.

A.I Border levy

The Law of Ukraine #2659-III of July 12, 2001 reworded the previous version of the law concerning single levy payable at the checkpoints of the border of Ukraine and introduced fixed rates of the single levy.

A.J Local Taxes

Pursuant to the Law of Ukraine #2515-III of June 7, 2001 "Concerning Amendment to Certain Legislative Acts of Ukraine", the tourism levy was excluded from the list of local taxes levied in Ukraine.

A.K Other normative documents

During the year of 2001 a number of normative documents relating to taxation were issued by the Cabinet of Ministers, State Tax Administration, Ministry of Finance and other regulating bodies. These documents are not covered by this summary.